

# FERC V. EPSA AND ADJACENT STATE REGULATION OF CUSTOMER ENERGY RESOURCES

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## INTRODUCTION

The Supreme Court's decision in *Federal Energy Regulatory Commission v. Electric Power Supply Ass'n* ("EPSA")<sup>1</sup> was a major victory for demand response—efforts to coordinate customers *not* using energy—in wholesale electric power markets. Justice Kagan's decision for a six-Justice majority<sup>2</sup> recognized that a watt is a watt, regardless of whether its source is a power producer or a customer (or group of customers) forgoing energy consumption. EPSA's majority viewed demand response as vital to promoting reliability and efficiency in energy markets. In upholding the Federal Energy Regulatory Commission's ("FERC") rules to encourage participation of demand response resources in wholesale demand power markets, the Court ended an ongoing battle surrounding compensation of demand response providers. Regulatory certainty about demand response resources will help to relieve congestion, reduce the need for new power plants, and promote renewable sources of energy.<sup>3</sup>

This Essay explores EPSA's implications on FERC's jurisdiction over customer-level clean energy resources such as state net metering policies for rooftop solar and energy storage programs. Since the Federal Power Act's ("FPA") adoption by Congress in 1935, most judicial decisions have ap-

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<sup>1</sup> 136 S. Ct. 760 (2016).

<sup>2</sup> This 6-2 line up is somewhat unusual: Justice Kagan wrote the majority opinion, which was joined by Chief Justice Roberts, along with Justices Kennedy, Breyer, Ginsburg, and Sotomayor. As discussed below, Justice Scalia wrote a dissent, which was joined by Justice Thomas. Justice Alito did not participate in review of the case or the decision.

<sup>3</sup> See, e.g., Darius Dixon, *Supreme Court Backs Federal Authority in Power Saving Rule*, POLITICO (Jan. 25, 2016), <https://perma.cc/BDA2-6A6Y?type=image> (quoting Environmental Defense Fund President Fred Krup, "Today's Supreme Court decision is a victory for all Americans who want greater choice and value broader customer access to clean, low-cost energy"); *id.* (quoting Allison Clements of Natural Resources Defense Council, who said the decision is key "because demand response is flexible and fast-acting, [so] it enables the affordable integration of more wind and solar power into the electricity transmission grid").

proached federal-state jurisdictional disputes with reference to a jurisdictional “bright line.”<sup>4</sup> Rather than fixate on this divide, the *EPSA* majority approached FERC’s jurisdiction in a functional manner, endorsing pragmatism over formalism in the regulation of energy markets. Unlike many past cases that fixated on a jurisdictional bright line, *EPSA* did not define a turf for state policymaking as beyond FERC’s reach but instead recognized how state policies operate adjacent to FERC’s regulation of practices affecting wholesale rates. As the first Supreme Court case to explicitly recognize cooperative federalism programs in the regulation of modern energy markets under the FPA, *EPSA* is also a victory for state policy flexibility. At the same time, its endorsement of expansive FERC authority to address discriminatory practices will only help to ensure that state clean energy policies complement—and do not work at odds with—competitive, efficient and reliable energy markets.

### I. *EPSA*’s Pragmatism in Defining FERC’s Jurisdiction

*EPSA* resoundingly rejected a D.C. Circuit panel conclusion that FERC’s demand response regulation (Order 745) is *ultra vires* under the FPA because it regulates retail sales.<sup>5</sup> In reversing the D.C. Circuit, *EPSA* held that FERC’s authority to adopt Order 745 is firmly supported by the clear language of sections 205 and 206 of the FPA. According to the majority, the language of the FPA should not be read “against its clear terms, to halt a practice [such as demand response] that so-evidently allows the Commission to fulfill its statutory duties of holding down prices and enhancing reliability in the wholesale energy market.”<sup>6</sup>

In contrast to the D.C. Circuit, the *EPSA* majority reasoned that the FPA clearly authorizes FERC to regulate compensation for customer demand

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<sup>4</sup> As the Court stated more than 50 years ago:

Congress meant to draw a bright line easily ascertained, between federal and state jurisdiction, making unnecessary [] case-by-case analysis [of conflicts]. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the states.

Fed. Power Comm’n v. S. Cal. Edison, 376 U.S. 205, 215–16 (1964).

<sup>5</sup> See *EPSA v. FERC*, 753 F.3d 216 (D.C. Cir. 2014). The D.C. Circuit also held that FERC’s rule was arbitrary and capricious under the Administrative Procedure Act (“APA”) because FERC failed to provide a “direct response” to some of the objections made by commentators who maintained FERC’s rules would overcompensate demand response, resulting in discriminatory rates. *Id.* at 224–25.

<sup>6</sup> *EPSA*, 136 S. Ct. at 764. The Court upheld FERC’s demand regulations against an arbitrary and capricious standard, reversing the D.C. Circuit on this ground as well. *Id.* at 773.

response participation in interstate energy markets. Order 745 did not attempt to regulate demand response as a wholesale sale of energy. Rather, FERC based its adoption of Order 745 on the FPA's delegation to the agency of authority to address "practices . . . affecting" its jurisdictional sales,<sup>7</sup> because the agency concluded that failure to regulate demand response participation would encumber competitive, efficient, and reliable wholesale power markets.

Agreeing with FERC, the *EPSA* majority rejected the D.C. Circuit's argument that Order 745 represented an agency power grab that lacks any limiting principle. The Court reasoned that FERC's jurisdictional basis for Order 745 would not allow the agency to regulate any market activity, but (in accordance with established judicial precedents) only those practices that *directly* affected wholesale markets. Demand response "pays consumers for commitments to curtail their use of power, so as to curb wholesale rates and prevent grid breakdowns,"<sup>8</sup> which according to the Court is within the agency's clear statutory authorization "with room to spare."<sup>9</sup> Excluding wholesale demand response from FERC's jurisdiction, the Court added, would "prevent[] all use of a tool that no one . . . disputes will curb prices and enhance reliability in the wholesale electricity market."<sup>10</sup>

The *EPSA* majority also rejected the D.C. Circuit's conclusion that the FPA reserves to state regulators exclusive authority over retail customer participation in wholesale demand response markets. Section 201(b) of the FPA expressly states that the provisions of the statute do not apply to "any other sale of electric energy" (other than wholesale sales). The D.C. Circuit had relied on this language to conclude that "[b]ecause FERC's rule entails direct regulation of the retail market—a matter exclusively within state control—it exceeds the Commission's authority."<sup>11</sup> *EPSA*'s majority noted that setting retail rates is beyond FERC's jurisdiction under the plain terms of this provision of the FPA, but in Order 745 "the Commission has not regulated retail sales."<sup>12</sup> FERC's regulation of demand response does not violate the FPA's proscription on regulating "any other sale" "just because it affects—even substantially—the

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<sup>7</sup> 16 U.S.C. §§ 824d(a), 824e(a).

<sup>8</sup> *EPSA*, 136 S. Ct. at 770.

<sup>9</sup> *Id.* at 774.

<sup>10</sup> *Id.* at 773.

<sup>11</sup> *EPSA v. FERC*, 753 F.3d 216, 224 (D.C. Cir. 2014). In a dissent, Judge Harry Edwards treated the jurisdictional issue as ambiguous under the FPA, and indicated that he would have deferred to FERC's interpretation of the statute. *Id.* at 227.

<sup>12</sup> *EPSA*, 136 S. Ct. at 773.

quantity or terms of retail sales.”<sup>13</sup> Rather, the Court reasoned, “When FERC regulates what takes place on the wholesale market, as part of carrying out its charge to improve how the market runs, then no matter the effect on retail rates [the FPA] imposes no bar.”<sup>14</sup>

In upholding FERC’s jurisdiction to adopt Order 745, *EPSA* made a strong appeal to statutory purpose.<sup>15</sup> Congress adopted the FPA in 1935 to close the “*Attleboro* gap,” a regulatory void due to limits the Supreme Court had imposed on state regulation under the dormant Commerce Clause.<sup>16</sup> As the Supreme Court has consistently noted, in adopting the FPA “Congress interpreted [*Attleboro*] as prohibiting state control of wholesale rates in interstate commerce for resale.”<sup>17</sup> Additionally, if FERC were to lack jurisdiction over demand response, the majority warned, no regulator—federal or state—would be able to address activities regarding demand response in wholesale power markets, since “state commissions could not regulate [wholesale] demand response bids either.”<sup>18</sup> Drawing a parallel to *Attleboro*, the majority added, “Congress passed the FPA precisely to eliminate vacuums of authority over the electricity markets.”<sup>19</sup>

Justice Scalia’s dissent in *EPSA*, joined by Justice Thomas, called the majority’s jurisdictional analysis “extravagant.”<sup>20</sup> It is perhaps fitting that Justice Scalia’s last published dissent before his untimely death took aim at the *EPSA* majority’s focus on statutory purpose, given his distaste for the use of legislative history in the interpretation of statutes. He raised particular concern with the majority’s reference to a 1961 decision that interpreted the Natural Gas Act so as to avoid the creation of a regulatory “no man’s land.”<sup>21</sup> In that opinion, the Court noted that “in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given

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<sup>13</sup> *Id.* at 776.

<sup>14</sup> *Id.* at 764.

<sup>15</sup> As the Court noted, its determination is based on the clear language of the statute, not any sort of deference to the agency. *Id.* at 773 n.5 (citing *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984)).

<sup>16</sup> *Pub. Utils. Comm’n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

<sup>17</sup> *United States v. Pub. Utils. Comm’n of Cal.*, 345 U.S. 295, 308 (1953). *See also* *New York v. FERC*, 535 U.S. 1, 6 (2002) (“When it enacted the FPA in 1935, Congress authorized federal regulation of electricity in areas beyond the reach of state power, such as the gap identified in *Attleboro* . . .”).

<sup>18</sup> *EPSA*, 136 S. Ct. at 780.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 788 (Scalia, J., dissenting).

<sup>21</sup> *Fed. Power Comm’n v. Transcon. Gas Pipe Line Corp.*, 365 U.S. 1, 19–20 (1961).

area and, if we find it cannot, we are impelled to decide that federal authority governs.”<sup>22</sup> By preventing the creation of “any” regulatory “no man’s land,” the *EPSA* majority explained, “The [Federal Power] Act makes federal and state powers ‘complementary’ and ‘comprehensive,’ so that “there [will] be no ‘gaps’ for private interests to subvert the public welfare.”<sup>23</sup>

A practical consequence of *EPSA*’s focus on this statutory purpose of closing regulatory gaps is that the FPA’s allocation of federal-state authority over practices affecting rates cannot always result in a strict separation of authority, as a jurisdictional bright line would dictate. Rather, to the extent the FPA does not expressly foreclose it, the statute authorizes both federal *and* state regulators to regulate the same activities in energy markets. FERC’s regulation of demand response occurs against the backdrop of a variety of different state policy approaches regarding customer demand response in retail markets, which encourages state experimentation. State policy flexibility regarding customer demand response has allowed new technologies and markets to develop to fit regional circumstances. FERC’s expansive authority over practices affecting rates allows FERC to step in, if necessary, while also promoting complementary forms of state regulation—thus ensuring that no aspect of demand response participation in interstate energy markets goes unregulated.

## II. Pragmatic Experimentation in Regulation of Customer Energy Resources

*EPSA* recognized how FERC’s jurisdiction over wholesale energy market practices—such as demand response—is not fixed. As customer energy resource technologies and markets evolve, it is inevitable that FERC’s jurisdiction will expand into some arenas state regulators once considered exclusively their own turf. At the same time, *EPSA* showed the potential for FERC’s regulation of energy markets to pragmatically accommodate adjacent and complementary state policy experimentation.

Despite the majority’s recognition of FERC’s authority to address demand response, *EPSA* also leaves state regulators considerable flexibility to pursue their own adjacent policy experiments with retail customer demand response. In upholding Order 745, the Supreme Court was careful not to invite top-down regulation of clean energy initiatives. Indeed, *EPSA* was particularly

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<sup>22</sup> *Id.*

<sup>23</sup> *EPSA*, 136 S. Ct. at 780.

attentive to the significance of private and state policy initiatives in encouraging the development of customer demand response resources.

State-led policy experimentation with customer energy resources is consistent with the basic jurisdictional principles FERC endorsed in its regulation of demand response. To begin, *EPSA* rejected the D.C. Circuit's specious argument that Order 745 overreaches because it "lure[s]" retail customers into the wholesale market.<sup>24</sup> The Court reasoned that FERC's regulation of demand response compensation is driven by the customer's decision to participate in wholesale energy markets: If a retail customer forgoing energy consumption does not choose to bid into wholesale demand response markets, it simply is not subject to FERC's jurisdiction under the FPA.

Also of significance, *EPSA* upheld FERC's demand rules as a "program of cooperative federalism." Order 745 (which extends FERC's earlier policy in Order 719) "allows any State regulator to prohibit its consumers from making demand response bids in the wholesale market," thus giving states "the means to block whatever 'effective' increases in retail rates demand response programs might be thought to produce."<sup>25</sup> This "opt out" option allows FERC to set basic expectations for demand response resources in wholesale markets without discouraging state regulators from experimenting with a wide range of complementary approaches to promote energy conservation.

Allowing state experimentation in retail customer demand response policies to continue adjacent with FERC's regulation of practices affecting wholesale rates can produce significant benefits. State flexibility in approaching demand response has promoted diverse policy experiments with customer demand response, especially given differences in state approaches to utility regulation. As a bottom-up approach, such policy flexibility has allowed demand response resources to develop while also enabling markets and regulators to learn about the viability of various retail customer demand response initiatives.

In a similar manner, *EPSA* sets the stage for state customer energy policies, such as net metering and customer storage programs, to flourish. To the extent that customer energy resource programs address distribution or generation facilities, the plain language of Section 201(b) of the FPA would appear to foreclose FERC from regulating them at all. Beyond this express prohibition on the regulation of certain facilities, *EPSA* clarifies that FERC may still regulate wholesale rates and practices that directly affect them. However,

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<sup>24</sup> *Id.* at 778.

<sup>25</sup> *Id.* at 780.

FERC has consistently disavowed exercising any jurisdiction over customer compensation for net metering on the grounds that metering does not constitute a wholesale sale unless it results in a net sale over the customer's billing period.<sup>26</sup> *EPSA* makes it undeniably clear that state regulators should retain flexibility in approaching net metering policies. Other state policy initiatives for customer energy resources, such as incentives for retail customer energy storage, similarly would benefit from allowing states flexibility to experiment with their own policy approaches.

After *EPSA*, however, it is also clear that the language of the FPA does not provide a fixed safe harbor that automatically exempts all state policy experimentation from FERC's reach, as a bright line approach to jurisdiction would suggest. Rather, the FPA's allocation of federal-state authority in this context is pragmatic and allows for adjacent state policies that *complement* FERC's regulatory initiatives under the FPA. There still must be some outer limit on what states can do in regulating customer energy resources, especially when states aim their initiatives at protecting incumbents at the cost of competitive, efficient, and reliable interstate markets.

At the extreme, no state can outright prohibit a power supplier from selling into the wholesale market, as this would encroach into FERC's jurisdiction over wholesale energy sales. As the Court made clear last term in *ONEOK v. Learjet*,<sup>27</sup> state policies cannot target FERC jurisdictional programs, especially in ways that conflict with them.<sup>28</sup> The Supreme Court's pending review of the Fourth Circuit's rejection of Maryland's capacity incentives for new natural gas plants (on federal preemption grounds) will help to clarify the extent to which states retain authority over generation incentives that overlap with FERC-approved market rules.<sup>29</sup>

Similarly, if demand response is to operate as a cooperative federalism program, FERC must ultimately possess some authority to address the most egregious barriers to customer participation in interstate energy markets. *EPSA*'s majority reasoned that FERC's demand response rule's "opt out"

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<sup>26</sup> Sun Edison LLC, 129 FERC ¶ 61,146 (2009), *order on reh'g* 131 FERC ¶ 61,213 (2010); MidAmerican, 94 FERC ¶ 61,340, at 62,262–64 (2001). For discussion, see Jim Rossi, *Federalism and the Net Metering Alternative*, ELECTRICITY J., Feb. 2016, at 13.

<sup>27</sup> *ONEOK, Inc. v. Learjet, Inc.* 135 S. Ct. 1591 (2015) (upholding state antitrust regulation of natural gas sales).

<sup>28</sup> *Id.* at 1599 (courts must consider "the *target* at which the state law aims in determining whether [the] law is pre-empted.").

<sup>29</sup> *PPL EnergyPlus, LLC v. Nazarian*, 753 F.3d 467 (4th Cir. 2014), *cert. granted*, *Hughes v. Talen Energy Mktg.*, 136 S. Ct. 382, No. 14-614 (Oct. 19, 2015); *CPV Maryland, LLC v. Talen Energy Mktg.*, 136 S. Ct. 356, No. 14-623 (Oct. 19, 2015).

opportunity for states (who may choose to eliminate customer bidding into wholesale demand response markets) “removes any conceivable doubt” as to its compliance with the allocation of federal-state authority under the FPA.<sup>30</sup> However, the majority’s analysis falls short of reasoning that the FPA requires FERC to allow a state to opt out any time it regulates activities that impact retail sales. Much like *New York v. FERC*<sup>31</sup> recognized FERC’s authority to regulate bundled retail transmission, even though the agency had not exercised this authority in its open access regulations,<sup>32</sup> *EPSA* envisions how the agency’s market policies can evolve and reach into some areas states previously may have regulated on their own. FERC’s opt-out policy certainly bolstered the rationality of the agency’s demand response regulations, in the view of the *EPSA* majority. But the Court did not conclude that state veto option is *required* by the FPA or *necessary* to support any federal regulation of state barriers to demand response as a practice affecting wholesale markets. As long as FERC exercises its authority over a practice that directly affects wholesale markets, nothing in the FPA requires the agency to always give the states a way of opting out of wholesale market policies.

For example, Order 745 allows states to prohibit any retail customer demand response participation in wholesale markets. In recognition of a diversity of state approaches, nothing in Order 745 also appears to require a state to endorse any specific retail demand response program, let alone eliminate state prohibitions on retail customer participation in wholesale markets. If, however, FERC were to make a finding that a state’s prohibition on retail customer bidding demand response resources into wholesale markets serves no purpose but to protect incumbents while significantly harming competition in interstate energy markets, agency elimination of this barrier could be warranted. Under current FERC policies, some states similarly limit retail customers from providing excess energy from rooftop solar or energy storage to the grid, and some of these state barriers could similarly go too far.

*EPSA*’s recognition of flexibility for state retail demand response policies as long as these complementary federal energy market objectives can help us to understand how best to approach state policy experimentation with other customer energy resources. For example, states cannot prohibit utilities from offering net metering to retail customers. Under a statute Congress adopted in 2005, utilities are required to offer net metering “upon request,” and states are

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<sup>30</sup> *EPSA*, 136 S. Ct. at 780.

<sup>31</sup> *New York v. FERC*, 533 U.S. 1 (2002).

<sup>32</sup> *Id.* at 28 (noting that FERC’s choice not to assert jurisdiction over bundled retail transmission in its open access order “represents a statutorily permissible policy choice”).

required to consider net metering programs; to the extent a state regulatory authority declines to implement a net metering program, it is required to state the reasons for this in writing.<sup>33</sup> Even beyond this federal statutory standard, if FERC were to find that a state's regulatory prohibition on new entrants serves no purpose but benefitting incumbents while threatening competitive wholesale markets (as some state limits on third-party solar providers may), the agency could potentially address these barriers. For similar reasons, FERC appears to possess the authority to eliminate significant state barriers to retail customer energy storage resource participation in wholesale markets.

Order 745 was the culmination of an evolving major federal policy initiative to encourage wholesale demand response participation, while FERC's policies regarding many other customer energy resources, such as retail net metering and energy storage, remain inchoate. As with demand response, the agency may find it expedient to encourage states to pursue a broad range of policy options with net metering and customer storage, including allowing states to opt out by prohibiting customers from participating. It seems particularly important for FERC to consider using a cooperative federalism approach to encourage adjacent complementary state policy initiatives where new technologies are just getting off the ground.

## CONCLUSION

*EPSA* is far more than a victory for demand response participation in wholesale markets. It also invites policy experimentation, without fixing a sphere of authority for state regulators that lays beyond the FPA's reach. As with FERC's approach to demand response, the agency's regulatory initiatives for other customer energy resources should continue to consider cooperative federalism programs that provide flexibility, including the possibility of a state opt out. Just as important, a state veto is not required by the FPA and should not be understood as an invitation for parochialism or for protecting incumbents at the expense of competitive, efficient, and reliable interstate power markets. *EPSA* leaves states considerable leeway in adopting policy initiatives for customer energy resources, but FERC cannot shy away from exercising its statutory responsibility to set basic ground rules for interstate energy markets—including the elimination of significant state barriers, where warranted.

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<sup>33</sup> See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1251, 119 Stat. 966 (2005) (amending section 111(d) of the Public Utility Regulatory Policies Act of 1978).