

Memorandum:
January 29, 2016

U.S. Supreme Court decision in FERC v. Electric Power Supply Association, et al.

Several years ago, the Federal Energy Regulatory Commission (FERC) issued Order No. 745, a rule requiring RTOs and ISOs to pay end users the same price for not consuming electricity as it paid wholesale suppliers for selling it. The agency's term for this is "demand response" and it has elected to treat demand response, like power supply, as an energy resource. NRECA had joined three other industry groups in challenging the rule – the American Public Power Association, the Edison Electric Institute and the Electric Power Supply Association. We had collectively argued that FERC's rule amounted to unlawful regulation of retail sales (an exclusively state function) and that, even if FERC had authority, it was still arbitrarily overcompensating end users. In a 6-2 decision (one Justice abstaining), the Supreme Court today upheld Order No. 745 in its entirety.

The case had initially gone to the D.C. Circuit Court of Appeals, which had thrown out the rule based on both of the grounds NRECA had raised. But the Supreme Court accepted FERC's request to review the case and its decision today overturned the lower court's ruling, thereby upholding the agency's demand response rule.

In rejecting the argument that FERC was unlawfully regulating retail sales, Justice Kagan, writing for the Supreme Court, held that FERC had the authority to regulate practices affecting wholesale rates and that the rule fell squarely within that authority, even if it had an indirect effect on retail sales and retail prices. Dissenting, Justice Scalia (joined by Justice Thomas), agreed that FERC had broad authority to regulate wholesale sales and related practices. But, he said, RTO payments to end users not to consume electricity were, in fact, a direct form of retail sales regulation.

As to the pricing issue, NRECA had argued that paying end users the full locational marginal price (LMP) for curtailing electricity use would arbitrarily compensate them twice. They would receive a payment for their reduction in electricity demand, but would also pay a lower electricity bill because they were purchasing less electricity. The Court held that while this was a reasonable criticism, there were experts on both sides of the issue and that the agency had explained why it still thought it reasonable to pay demand response the same rate for each kwh not consumed as wholesale suppliers were paid for each kwh sold. The Court's role, Justice Kagan stated, was not to decide which pricing method was better, but whether the agency had given all the arguments fair consideration.

What does all of this mean going forward? There are two implications.

NRECA believed, and still believes, its jurisdictional objections were sound. Our bigger concern, however, was that FERC's rules overcompensate demand response and distort the market in the process. The jurisdictional issue is now settled. But while FERC has also been given the green light to order that demand response be paid at full LMP, it is not bound to do so. "We do not discount the cogency of [NRECA's] arguments favoring LMP-G. Nor do we say that in opting

for LMP instead, FERC made the better call. It is not our job to render that judgment on which reasonable minds can differ." In earlier cases, FERC had itself supported an LMP-G formulation urged by PJM. It is a fight for another day, but if we can make the case that full LMP is distorting the markets – and can convince RTOs – they might support a request that FERC revisit the compensation question.

A second implication of the Court's opinion is that it will almost certainly affect FERC's regulation of capacity markets. Order No. 745 dealt only with energy, not capacity prices. After the D. C. Circuit had reversed Order No. 745, several parties had filed complaints with FERC that the results of the PJM and ISO-New England capacity auctions should be thrown out because they included demand response. FERC deferred action on those complaints while the case remained before the Supreme Court. Now that the Supreme Court has rejected the jurisdiction arguments, it is likely to dismiss the complaints (which relied on the lower court's now overturned jurisdictional ruling).