No. 14-840

# In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

*v.*

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE DISTRICT OF COLUMBIA CIRCUIT*

**REPLY BRIEF FOR THE PETITIONER**


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As part of the process of balancing supply and demand in wholesale-electricity markets, the entities that operate those markets pay certain electricity users to curtail their consumption in specified circumstances. The operators then recoup those payments by adjusting the wholesale rate. The court of appeals held that the Federal Energy Regulatory Commission (FERC) lacks authority to ensure that the level of compensation paid for that curtailment—and recouped through the wholesale rate—is just and reasonable, despite FERC's plenary authority to regulate "any rule, regulation, practice, or contract affecting [a wholesale] rate." 16 U.S.C. 824e(a).

That decision is wrong, and it deprives FERC of an important tool for ensuring that wholesale rates are just and reasonable. The decision casts a pall over

FERC's efforts to regulate any aspect of demand response in wholesale-electricity markets. Respondents do not disavow that import of the ruling. Indeed, they appear to read the decision below to bar wholesale-market operators from employing demand-response commitments at all. That outcome would increase the price of wholesale electricity and erode the reliability of the national power grid. Given those consequences, no sound basis exists for this Court to deny review of the court of appeals' construction of the Federal Power Act (FPA).

**A. The Decision Below Misconstrues The FPA**

Respondents' arguments do not rehabilitate the court of appeals' seriously flawed statutory interpretation.

1. As an initial matter, respondents' defense of the decision below obscures the practices addressed by FERC's Rule in two significant ways.

First, the Rule has nothing to do with *retail*-level demand-response programs, such as where a local utility pays customers to refrain from using power at peak times. Rather, it addresses only *wholesale*-level demand-response programs. Under those programs, the entities that operate wholesale auction markets and set wholesale rates—in FERC-speak, RTOs and ISOs—pay certain end-users not to consume power in specified circumstances and recoup those payments by adjusting the wholesale rate.

Respondents weave an elaborate story about FERC's frustration at "States' unwillingness to follow the federal lead in adopting dynamic pricing." Br. in Opp. 2; see *id.* at 1, 7-8, 16, 18. But FERC did not identify frustration with state efforts as a basis for its authority to adopt the Rule. See Pet. App. 59a, 138a, 223a. Respondents rely primarily on a comment at a technical conference by a single Commissioner (who was merely responding to the suggestion that wholesale demand response could impede efforts to develop retail-level demand-response technology). See Br. in Opp. at 8, 18 (citing C.A. App. 1135). The purpose of the Rule is to correct inefficiencies and improve pricing, reliability, and competitive conditions in *wholesale* energy markets. Pet. App. 59a-61a. And as three state commissions explain in a brief supporting this Court's review, the Rule complements state-level efforts rather than displacing them. See Joint State Resp. Br. 22-29.

Second, echoing the mistake of the court of appeals, respondents repeatedly suggest (Br. in Opp. 10, 18, 20, 22, 23, 25, 27) that in promulgating the Rule, FERC has "directed," "ordered," or "[f]orc[ed]" wholesale-market operators to use demand-response resources. Those contentions reflect a basic misunderstanding of the Rule. See Pet. App. 33a (Edwards, J., dissenting). The regulation adopted in the Rule provides that each wholesale-market operator "that has a tariff provision permitting demand response resources to participate as a resource in the energy market" must use the Rule's formula to compute the payments to demand-response providers. 18 C.F.R. 35.28(g)(1)(v). In other words, the Rule provides that *if* a wholesale-market operator independently elects to use demand-response resources, then it must use the Rule's payment formula to ensure that the resulting wholesale rates are just and reasonable.

In a prior order in 2008, FERC required wholesale-market operators to permit demand-response resources to provide ancillary services and to allow demand-response aggregators to bid into wholesale markets (unless they were forbidden to do so by state authorities). See Pet. 9; Pet. App. 62a. That order was not challenged and was not before the D.C. Circuit in this case. And in any event, before that order, wholesale-market operators had voluntarily adopted demand-response programs in wholesale energy and capacity markets by obtaining FERC approval of changes to their tariffs. See Pet. App. 63a; see also, *e.g.*, *New York Indep. Sys. Operator, Inc.*, Order on Tariff Filing, 95 F.E.R.C. ¶ 61,223 (2001). Accordingly, even if FERC lacked authority to *require* wholesale-market operators to accept demand-response bids, that would have no bearing on the question in this case: whether, if operators do use demand-response resources, FERC may ensure that the level of compensation produces just and reasonable wholesale rates.

2. When considered in light of the actual scope of the Rule (rather than respondents' erroneous characterization of it), respondents' arguments do not come close to establishing that "the statutory text forecloses [FERC's] assertion of authority." *City of Arlington* v. *FCC*, 133 S. Ct. 1863, 1870-1871 (2013).

FERC's statutory argument is straightforward. In balancing supply and demand, wholesale-market operators pay for demand-response commitments and then fund the payments through adjustments to wholesale rates. The Rule prescribes a formula for computing those payments to ensure that the resulting wholesale rates are just and reasonable. Accordingly, under the plain text of the FPA, the compensation paid by wholesale-market operators constitutes a "rule, regulation, practice, or contract affecting [a wholesale] rate" under 16 U.S.C. 824e(a). And if there were doubt on that score, FERC's interpretation is entitled to *Chevron* deference. See Pet. 28-29.

In response to FERC's interpretation, respondents do not make any argument that demand-response payments by wholesale-market operators fall outside the plain text of Section 824e(a). Rather, respondents argue that the Rule represents "an attempt to regulate retail sales," and thus is expressly prohibited by Section 824(b). Br. in Opp. 16-19. But tellingly, not even the panel majority found that argument persuasive. See Pet. App. 9a n.1 (explaining majority's view that "demand response, while not necessarily a retail *sale*, is indeed part of the retail *market*," and holding that "we do not base our conclusion on the 'any other sales' language of [Section 824(b)(1)]"). It is not hard to see why: A commitment to refrain from consuming electricity does not involve a retail sale. That respondents feel compelled to defend the decision below on a basis expressly disavowed by the panel majority demonstrates that the court of appeals went seriously astray in its statutory interpretation.

Moreover, elsewhere respondents appear to acknowledge that a demand-response payment is not a retail sale, but rather is a practice that *affects* retail sales. See Br. in Opp. 23-24. The FPA, however, contains no bar to FERC's regulation of practices *affecting* retail sales. If FERC were to increase the wholesale rate, after all, that would similarly affect "the quantity" and "the price" of retail sales (*id.* at 24). Where a practice, like wholesale demand response, directly affects wholesale rates and sales, FERC has authority to regulate it, even if that regulation also affects retail sales.

Respondents do follow the panel majority in relying on the FPA's policy statement, 16 U.S.C. 824(a)—while entirely ignoring this Court's longstanding admonition that the "precise reserved state powers language in [Section 824(a)] [is] a mere policy declaration that cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose." *New York* v. *FERC*, 535 U.S. 1, 22 (2002) (internal quotation marks omitted) (quoting *FPC* v. *Southern Cal. Edison Co.*, 376 U.S. 205, 215 (1964)). Accordingly, without any argument that the practices at issue here fall outside the specific grant of jurisdiction in Section 824e(a), respondents cannot prop up the decision below with the FPA's policy declaration.

Finally, like the court of appeals, respondents contend that FERC's exercise of authority here lacks a limiting principle because wholesale demand-response programs "affect wholesale rates * * * only in the same way that retail sales inevitably affect wholesale rates." Br. in Opp. 2. That argument overlooks a fundamental difference: The demand-response commitments at issue here are used to balance supply and demand in real-time and day-ahead auction markets run by *wholesale*-market operators, and the payments are funded directly through adjustments to *wholesale* rates. They are, in other words, part of the rules of the game for wholesale markets. That is not true of retail-sales regulation. Even less plausibly, respondents also assert (*id.* at 21) that under FERC's view, "FERC could strip States of all jurisdiction to regulate retail sales merely by inviting all retail customers to purchase power directly from the wholesale markets." But that *would* involve directly regulating a retail sale and would thus violate Section 824(b)'s express bar.

3. Respondents conspicuously refuse to explain how they think wholesale demand-response payments should be regulated. Under the decision below, there are three options, all of them contrary to the FPA's broad grant of authority to FERC. See Pet. 25-28. Respondents do not appear to endorse the first two: leaving demand-response programs in the wholesale market entirely unregulated or permitting state utility commissions to regulate them. Indeed, certain respondents here have correctly explained in other cases pending before this Court that "a state may not manipulate prices in the federally regulated wholesale market." Br. in Opp. at 20, *Nazarian* v. *PPL EnergyPlus, LLC*, No. 14-614 (Feb. 11, 2015). If a state agency were to tell a wholesale-market operator when and how it can set rates using demand-response commitments, however, it would be doing just that. And if multiple state agencies attempted to regulate demand response for a single wholesale-market operator, the operator could be faced with irreconcilable legal rules governing the same practice.

That leaves the third possibility: that wholesale-market operators may not allow participation by demand response *at all*, even though it helps their auction markets run more efficiently, reduces system disruptions, and lowers wholesale rates. Although respondents do not expressly say as much, that appears to be their position. See Br. in Opp. 15, 31-32, 37-38; see also Pet. 27. Respondents thus may read the FPA to implicitly bar any incorporation of a tremendously beneficial pricing mechanism into wholesale markets—a strange interpretation of the FPA's broad grant of federal jurisdiction, to say the least. That view would also repudiate the position respondents themselves took in the administrative proceedings, where they stated that they "fully support[] participation by diverse resources, including [demand-response] resources, in wholesale energy markets," Joint Req. for Reh'g 2, FERC Docket No. RM10-17 (Apr. 14, 2011), and that "[w]ell-functioning wholesale competitive markets should include appropriately-designed economic [demand response] and other load response programs," PPL Parties Comments 2, FERC Docket No. RM10-17 (May 13, 2010).

In any event, the fact that even respondents appear to believe that the decision below effectively prohibits the use of demand-response commitments in wholesale markets *at all* demonstrates that the question presented has overriding national importance.

**B. The Question Presented Warrants This Court's Review**

Respondents provide no compelling reason to deny this Court's review of the D.C. Circuit's sweeping statutory-authority holding. See Br. in Opp. 27-38.

1. Respondents observe (Br. in Opp. 15, 27) that no circuit conflict exists on the question whether FERC may regulate the level of compensation paid by wholesale-market operators for demand-response bids. But they do not contest the critical point: that it is unlikely that a circuit conflict would ever arise, because the FPA's judicial-review provision, 16 U.S.C. 825*l*(b), permits any party to seek review of a FERC order in the D.C. Circuit. See Pet. 35. Thus, if FERC were to attempt to exercise authority to regulate wholesale demand-response payments again, any party could challenge FERC's action in the D.C. Circuit, and a reviewing panel would be bound by the

decision below. This case thus resembles cases raising important questions of patent law that could be decided only by the Federal Circuit. See, *e.g.*, *Commil USA, LLC* v. *Cisco Sys., Inc.*, No. 13-896 (argued Mar. 31, 2015); *Teva Pharms. USA, Inc.* v. *Sandoz, Inc.*, 135 S. Ct. 831 (2015).

2. Respondents contest (Br. in Opp. 27-34) the importance of the question presented. That argument contradicts the expert judgment of FERC on matters of energy regulation. It also makes very little sense on its own terms. For example, respondents inexplicably contend (*id.* at 28) that the fact that the decision below, if allowed to stand, would deprive the Nation's electricity system of the significant benefits of the Rule does not qualify as a "potential harm[]" justifying further review. They also claim (*ibid.*), without citation, that FERC lacked evidentiary support for the Rule's many expected benefits. But both FERC's certiorari petition and the rulemaking record describe numerous studies and public comments demonstrating the benefits of demand-response programs in wholesale-electricity markets, see Pet. 31-33, and the very purpose of the Rule is to ensure an optimal level of demand-response participation. Respondents specifically take issue with only one of the substantial benefits that FERC identified—the mitigation of generators' market power—but FERC clearly concluded that the Rule would "help[] to limit potential opportunities for the exercise of market power." Pet. App. 227a-228a; see *id.* at 58a-60a & n.17.

Respondents' contention also contradicts the views of a diverse group of entities that have urged this Court to grant review, including industrial manufacturers, public school systems, a research university, state utility commissions, and over a dozen utilities. The state commissions, for example, explain that "[t]he panel's decision is of substantial national importance because if allowed to stand, it will have a highly disruptive impact on wholesale markets and system reliability, it will devalue massive public and private investment in demand response, and it will undermine state policy and environmental goals." Joint State Resps. Br. 15. The utilities likewise warn that the decision below will require wholesale purchasers to "pay far more to purchase electricity from generators," which "translates into higher prices for tens of millions of consumers." Fourteen Utilities Amicus Br. 4. And they further explain that the court of appeals' "reasoning * * * casts doubt on FERC's ability to regulate a host of other practices that significantly affect wholesale rates in the energy, capacity, and ancillary services markets." *Id.* at 11.

Even parties that opposed the Rule on the merits have urged this Court to grant review of the court of appeals' statutory holding. For example, the California Independent System Operator (CAISO), which operates California's wholesale-electricity system, explains that although "FERC and the CAISO disagree about the substantive merits" of certain aspects of the Rule, the court's statutory holding will "impede the development of demand-response strategies," "subject [wholesale-market operators] to an unworkable patchwork of demand response regulations," and "have far-reaching effects on the Nation's energy supply." CAISO Br. 8, 9, 13, 16 (capitalization altered). Similarly, amicus NRG Energy, Inc.—a member of respondent Electric Power Supply Association and a major marketer of wholesale power—

"supported [the] challenge to [the Rule] before the court of appeals" on the particular formula FERC adopted but has concluded that the court of appeals' statutory holding "will lead to many economic and operational inefficiencies." Amicus Br. 3, 21 (capitalization altered).

Respondents also ignore Congress's express intent in the Energy Policy Act of 2005 that FERC ensure that barriers to demand-response commitments are removed. 16 U.S.C. 2642 note. While the petition did not claim that the statement is a "grant of authority" (Br. in Opp. 27)—which would be unnecessary in light of FERC's authority to regulate practices directly affecting wholesale rates—it reflects Congress's recognition of the immense importance of demand-response commitments to the national economy. See Pet. 34-35.

Without a serious argument that the decision below lacks national importance, respondents are left with the question-begging point that the "division of regulatory authority between the federal government and the States" can sometimes result in inefficient policies. Br. in Opp. 28. The very question presented here is whether the decision below *correctly identified* the dividing line between federal and state authority. That federalism principles, properly applied, can sometimes prove economically costly does not justify leaving in place an erroneous interpretation of the FPA that will hurt consumers and businesses over the long run.

3. Respondents contend (Br. in Opp. 15-16, 34-38) that this case presents a poor vehicle to consider FERC's statutory authority because the panel held that it would have vacated the Rule on the separate

ground that FERC did not sufficiently respond to Commissioner Moeller's concerns about the Rule's formula. Although respondents state that FERC is asking for an "advisory opinion," they make no argument that this Court lacks jurisdiction to consider only the broader statutory-authority holding. With good reason: Under the panel majority's primary holding, FERC is barred from repromulgating the Rule in any form, whereas under the secondary holding, FERC could repromulgate the Rule with a response to the court's holding on the payment formula, or could adjust the payment formula. There can be no doubt, therefore, that FERC retains a clear stake in the case even if it does not seek review of the narrower secondary holding.[*]

The denial of review that respondents urge would result in a needless waste of administrative resources and inject enormous uncertainty into the regulated markets while FERC and market actors await an authoritative resolution of the question presented, potentially years down the road. Indeed, if respondents were correct that the promulgation of the Rule itself has created "massive distortions" (Br. in Opp. 36), then postponing a decision from this Court about whether FERC has authority to promulgate a similar rule in the future would only prolong the deleterious uncertainties.

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[*] In any event, as FERC explained in its petition (at 36), if the Court harbored doubts about its ability to consider the question presented, it could broaden it to ask whether the court of appeals erred in vacating the Rule.

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For the foregoing reasons and those stated in the petition for a writ of certiorari, the petition should be granted.

Respectfully submitted.

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