Nos. 14-840, 14-841

IN THE

Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.,
Respondents.

ENERNOC, INC. ET AL.,
Petitioners,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF INDIANA, OKLAHOMA, AND TEN STATES AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENTS

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QUESTIONS PRESENTED

(1) Whether the Federal Energy Regulatory Commission reasonably concluded that it has authority under the Federal Power Act, 16 U.S.C. § 791a *et seq.*, to regulate the rules used by operators of wholesale electricity markets to pay for reductions in electricity consumption and to recoup those payments through adjustments to wholesale rates.

(2) Whether the Court of Appeals erred in holding that the rule issued by the Federal Energy Regulatory Commission is arbitrary and capricious.

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INTEREST OF THE *AMICI* STATES

The States of Indiana, Oklahoma, Alabama, Arizona, Arkansas, Idaho, Kansas, South Carolina, Texas, West Virginia, and Wyoming respectfully submit this brief as *amici curiae* in support of Respondents. Since its enactment in 1935, the Federal Power Act has guaranteed to States regulatory authority over *retail* electricity rates and facilities and has permitted a federal agency (formerly the Federal Power Commission, now the Federal Energy Regulatory Commission, or "FERC") to regulate only *wholesale* inter-state electricity markets. Order 745, by incentivizing retail customers to enter the wholesale market—and thereby regulating retail transactions—far exceeds the boundaries of FERC's statutory jurisdiction. The States urge this Court to affirm the Court of Appeals and protect States' traditional authority over retail electricity rates and facilities from encroachment by a federal administrative agency.

SUMMARY OF THE ARGUMENT

This case is fundamentally about whether a federal administrative agency can, in contravention of explicit federal statutory language and nearly a century of precedent, enact and enforce a regulation that regulates retail transactions and effectively pushes retail customers into the federally regulated wholesale market. The regulation at issue, Order

745 of the Federal Energy Regulatory Commission (FERC), purports to set compensation rates for "demand response," a resource created when electricity retail customers agree to reduce consumption in exchange for incentive payments. These reductions in demand are called "negawatts" (in parallel to the megawatts that generators produce). Specifically, Order 745 essentially requires wholesale market administrators to pay retail customers, often through demand response providers known as curtailment service providers, the same amount for each "negawatt" as they pay energy producers for each megawatt. In other words, consumers would be paid as much for the electricity they *do not use* as power companies would be paid for the electricity they *produce*.[1]

Order 745 is a blatant intrusion into traditional authority of States and an attempt to circumvent express restrictions on FERC's jurisdiction. FERC has already mandated "dynamic pricing"—a system where prices adjust rapidly to changes in market conditions—in the wholesale market (over which it has jurisdiction). Some States have followed suit at the retail level, but many—including Indiana, Oklahoma, Alabama, Arizona, Arkansas, Idaho, Kansas, South Carolina, West Virginia, and

[1] All electricity consumption is necessarily *retail* consumption; thus, in this brief, the terms "retail customer" and "consumer" are used interchangeably.

Wyoming—have retained their traditional, stable, fixed-rate price systems.[2] FERC's objective is to force all States to switch to retail-level dynamic pricing that it prefers, but it lacks authority to do so directly. Its strategy is to lure consumers to the wholesale market and its preferred pricing system. The Court of Appeals correctly recognized that this scheme "goes too far, encroaching on the states' exclusive jurisdiction to regulate the retail market." *Elec. Power Supply Ass'n v. Fed. Energy Regulatory Comm'n*, 753 F.3d 216, 218 (D.C. Cir. 2014). Accordingly, it vacated the Order *in toto*. *Id.* at 225.

That was the correct decision. Most importantly, the Court of Appeals recognized Order 745's extra-jurisdictional nature; both the federal statute and nearly a century of tradition plainly establish that regulating retail electricity is the States' sole province. Even if the precise boundaries of that province were unclear, any ambiguity should be resolved in favor of State, rather than federal, authority. And it is simply bad public policy to force States to adopt a regulatory model they have deemed unsuitable for the particular needs of their residents.

This case does not require judicial evaluation of whether demand response is a good idea. All agree

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[2] Texas has dynamic wholesale pricing inside the Electric Reliability Council of Texas, an intrastate electric grid based on ERCOT protocols.

that it is, properly calibrated to the circumstances. Rather, this case is about what sovereign is best suited to manage *consumer* demand response. Congress believes it is the States, who are more closely connected to both electricity generators and the retail customers they serve. The Court should not permit FERC to enforce regulate transactions so far outside its jurisdiction.

The Amici States therefore join Respondents in urging the Court to affirm the decision below and ensure thereby that States may continue to select the electricity pricing system most beneficial for their citizens. The alternative is to permit federal officials with no electoral accountability to force on the entire Nation a novel, untested, one-size-fits-all approach to regulation of retail electricity transactions—and, ultimately, distribution of vital energy resources to consumers.

ARGUMENT

I. Order 745 Infringes State Authority Over Retail Electricity Transactions

A. The Federal Power Act preserves States' long-held exclusive authority over retail electricity sales

In the early days of American electrification, it became apparent that electric utilities were "natural monopolies" because they required large capital

investments to build and maintain necessary infrastructure (such as generation facilities and transmission lines) and were susceptible to economies of scale. William Boyd, *Public Utility and the Low-Carbon Future*, 61 UCLA L. Rev. 1614, 1638–39 (2014). As such, traditional anti-trust law proved an ineffective means of regulating electric utilities, and by 1930, every state but Delaware had enacted legislation establishing a state administrative agency to balance the interests of ratepayers with those of investors. *Id.* at 1639–40. Accordingly, electric utilities became vertically integrated monopolies; each utility controlled the power plants, the transmission lines, and the distribution lines, and each region was served by a single utility. Sharon B. Jacobs, *Bypassing Federalism and the Administrative Law of Negawatts*, 100 Iowa L. Rev. 885, 891–92 (2015). In exchange for a grant of monopoly in a particular region, a utility ceded control of its rates to the State Public Utility Commission (PUC). *Id.* at 892.

Matters proceeded in this wise, with State PUCs serving as the sole regulators of electricity markets, until *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927). In *Attleboro Steam*, a Massachusetts retailer challenged the Rhode Island PUC's authority to set the rate it had to pay a Rhode Island generator. The Court sided with the plaintiff, reasoning that because the transaction involved the interstate sale

of electricity, the Rhode Island PUC's rate order violated the Commerce Clause. *Id.* at 89. "[I]f such regulation is required it can only be attained by the exercise of the power vested in Congress." *Id.* at 90.

That decision "pav[ed] the way for federal regulation of public utilities." David B. Spence & Robert Prentice, *The Transformation of American Energy Markets and the Problem of Market Power*, 53 B.C. L. Rev. 131, 142 (2012). In 1935, Congress passed the Federal Power Act, which granted the Federal Power Commission (FERC's predecessor agency) jurisdiction over ""transmission of electric energy in interstate commerce and the sale of such energy *at wholesale* in interstate commerce." 16 U.S.C. § 824(a) (emphasis added); *see also id.* at § 824(d) (defining "sale of electric energy at wholesale" as "a sale of electric energy to any person for resale."). But the Act also expressly limited federal jurisdiction "only to those matters which are not subject to regulation by the states." *Id.* at § 824(a). This division of regulatory labor—wholesale transactions under federal authority and retail transactions under State authority—remains unchanged today. State PUCs continue to ensure reliable service and fair pricing for retail customers.

B. The federally regulated wholesale markets facilitate interstate sale and allocation of energy, but take no account of issues relating to stable prices and capacity that arise on the local level

1. Even deregulation, which began in the late 1970s, has never purported to usurp State control over retail transactions. Congress began the process of deregulating the energy markets by enacting the Public Utility Regulatory Policies Act of 1978 (PURPA). Jacobs, *supra*, at 893. PURPA was intended in part to "assur[e] an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources . . . ." 16 U.S.C. § 824a(a). To those ends, it directed FERC to issue regulations requiring utilities to purchase electricity from independent generators that met prescribed efficiency, operational and other requirements. *See* 16 U.S.C. §§ 796(17)(A), (C), 796(18)(B), (C), 824a-3(l); 18 C.F.R. pt. 292.

Yet even so, Congress made clear that State PUCs retained authority to set rates for retail transactions. *See* 16 U.S.C. § 824a-3(a)–(b), (f). "Thus, the states play the primary role in calculating avoided costs and in overseeing the contractual relationship between [independent generators] and utilities operating under the regulations

promulgated by the Commission." *Indep. Energy Producers Ass'n, Inc. v. Cal. Pub. Utilities Comm'n*, 36 F.3d 848, 856 (9th Cir. 1994); *see also Pub. Serv. Co. of Oklahoma v. State ex rel. Oklahoma Corp. Comm'n*, 115 P.3d 861, 871 (Okla. 2005), *as corrected* (July 13, 2005) ("PURPA gives to state regulatory authorities the responsibility of determining a utility's avoided costs.").

The federal Energy Policy Act created additional incentives for independent generators with the aim of increasing wholesale market competition. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as amended at 42 U.S.C. § 13201); *see also* Jacobs, *supra*, at 893. In 1996, FERC issued Order 888, which made it easier for independent generators to transmit electricity to consumers by requiring utilities to allow those independent producers to use utility transmission networks at non-discriminatory prices. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, 61 Fed. Reg. 21,540, 21,541 (May 10, 1996) (codified at 18 C.F.R. pts. 35, 385); *see also* Jacobs, *supra*, at 893. And to help manage transmission and regulate prices, FERC "encouraged the creation" of organized wholesale markets overseen by Independent System Operators (ISOs) and Regional Transmission Operators (RTOs). Jacobs, *supra*, at 894 (citing Regional Transmission Organizations, 65

Fed. Reg. 810, 810, 812–13 (Jan. 6, 2000) (codified at 18 C.F.R. pt. 35)).

2. In today's deregulated environment, approximately half the Nation's electricity is transacted through wholesale markets overseen by ISOs and RTOs. Joel B. Eisen, *Who Regulates the Smart Grid?: FERC's Authority Over Demand Response Compensation in Wholesale Electricity Markets*, 4 San Diego J. Climate & Energy L. 69, 70 (2013). But unlike state PUCs, these wholesale markets do not require electricity generators to guarantee that they will be able to meet demand.

Nor do wholesale markets offer any bulwark to protect consumers against wildly fluctuating prices and catastrophic price spikes during times of high retail demand. There is simply no reliable way to prevent such spikes without regulation. Johannes Pfeifenberger et al., "A Comparison of PJM's RPM with Alternative Energy and Capacity Market Designs" at 3 (Sept. 2009).

California residents know this fact all too well; their state was the first, in 1998, to deregulate retail electricity transactions. Richard J. Pierce, Jr., *How Will the California Debacle Affect Energy Deregulation?*, 54 Admin. L. Rev. 389, 389 (2002). At first, other States enthusiastically followed suit, but in late spring of 2000, a reduction in the wholesale supply of electricity caused the retail price of

electricity to increase by over five hundred percent in only four months. *Id.* The California legislature responded by abruptly freezing the retail price, thus removing any incentive for consumers to reduce demand. Richard J. Pierce, Jr., *A Primer on Demand Response and a Critique of FERC Order 745*, 3 Geo. Wash. J. Energy & Envtl. L. 102, 103 (2012). There was simply not enough wholesale supply to meet that retail demand, and the result was rolling blackouts that were inconvenient, expensive, and sometimes even life-threatening. *Id.*; *see also* Margaret Talev, *At-Risk Patients Plan Ahead for Rolling Blackouts*, L.A. Times (Mar. 21, 2001), *available at* http://articles.latimes.com/2001/mar/21/local/me-40671 (describing how rolling blackouts endangered the welfare of patients on life support).

Concerned by issues that appeared with deregulation, the majority of States, including *amici* Indiana, Oklahoma, Alabama, Arizona, Arkansas, Idaho, Kansas, South Carolina, West Virginia, and Wyoming, have chosen to keep their retail transactions traditionally regulated.[3] In so doing, the States assure safe and reliable electric service at reasonable rates for retail customers by preserving

[3] Texas has deregulated retail electric rates for investor-owned utilities inside ERCOT, but has not yet expanded that retail deregulation in the areas outside ERCOT where FERC regulates wholesale rates.

state regulatory control over new facilities for generating electricity. Indiana, for instance, has required its electric utilities to engage in twenty-year "integrated resource planning" incorporating all types of energy resources, including demand response. Indiana also has allowed its electric utilities to join RTOs in order to achieve economies of scale in transmission planning and to participate in wholesale energy markets. State utility commissions thus incorporate provider competition, but counterbalance it with stability and reliability provided by traditional regulation. Yet FERC would upset these state-by-state balances and, exceeding its jurisdiction, regulate retail demand by inducing consumers to reduce retail purchases.

3. Order 745 is only FERC's latest attempt at an end-run around the limitations of its own jurisdiction. FERC has tried a similar stratagem in the past.

Over the past decade, the federal government has actively encouraged States to adopt regulatory policies that promote demand response. In 2005, Congress declared it "the policy of the United States that time-based pricing and other forms of demand response . . . shall be encouraged . . . and unnecessary barriers to demand response participation in energy, capacity and ancillary service markets shall be eliminated." 16 U.S.C. § 2642. The Indiana Commission responded with an

order encouraging demand response while preserving the State's authority over retail transactions. *In the Matter of the Commission's Investigation into Any and All Matters Related to Commission Approval of Participation by Indiana End-Use Customers in Demand Response Programs Offered by the Midwest ISO and PJM Inter-Connection*, Cause No. 43566, 2010 WL 3073664 (Ind. Util. Reg. Comm'n July 28, 2010) [hereinafter IURC Cause No. 43566].

FERC's Order 719 directed wholesale market administrators (ISOs and RTOs) to allow aggregated retail customers to bid demand response into the wholesale markets "comparably to other resources," unless State or local authorities opted out by legislation or rule. Wholesale Competition in Regions with Organized Elec. Mkts., 73 Fed. Reg. 64,100, 64,101 (Oct. 28, 2008) (to be codified at 18 C.F.R. pt. 35) [hereinafter Order 719]. State regulatory agencies, concerned both that FERC overstepped its jurisdiction and that opening wholesale markets to retail customers in this way would make it impossible for regulators to predict demand, opposed Order 719. At the notice-and-comment stage, the National Association of Regulatory Utility Commissions advocated on behalf of state regulators for an "opt-in" provision that would prevent retail customers from participating in wholesale markets unless the relevant state or local

regulator affirmatively allowed it. Jacobs, *supra*, at 933.

After FERC finalized the rule with the original opt-out provision included, several states, including *amici* Iowa, Indiana, Missouri, and Michigan, issued opt-out orders prohibiting or restricting aggregators from bidding retail demand response into wholesale markets without going through the appropriate retail electric utility. *See, e.g.*, *In re PURPA Standards in the Energy Indep. & Sec. Act of 2007*, Smart Grid Report and Order Continuing Prohibition of ARCs (Iowa Dep't of Commerce Utils. Bd. June 25, 2012), No. NOI-08-3, 2012 WL 2499366 at *2; IURC Cause No. 43566; *Detroit Edison Co., Request to Initiate Investigation of Licensing Rules, and Regulations Needed to Address the Effect of the Participation of Retail Customers*, No. U-16020, 2010 WL 5031082 (Mich. Pub. Serv. Comm'n Dec. 2, 2010) at 7; *In the Matter of an Investigation into the Coordination of State and Federal Regulatory Policies for Facilitating the Deployment of all Cost-Effective Demand-Side Savings to Electric Customers of All Classes Consistent With the Public Interest*, Order Temporarily Prohibiting the Operation of Aggregators of Retail Customers, No. EW-2010-018, 2010 WL 1422063 at *4 (Mo. Pub. Serv. Comm'n Mar. 31, 2010).

Regulators were concerned that without these prohibitions or restrictions, demand response

resources would cause an imbalance within the retail utility's distribution system and hamper efforts to forecast and meet retail demand. IURC Cause No. 43566 at 44. They were also worried that allowing retail customers to participate directly in the wholesale markets could shift costs to, and create risks for, the utility's remaining customers. Some, such as the Indiana Utility Regulatory Commission, continued to encourage demand response, but required that retail demand response participation in wholesale markets should be conducted through the retail electric utility. IURC Cause No. 43566 at 46.

A few years later, apparently dissatisfied with the low number of consumers participating in the wholesale markets, FERC issued Order 745, the Order at issue here. Demand Response Compensation in Organized Wholesale Energy Markets, 134 FERC ¶ 61,187, 2011 WL 890975 (Mar. 15, 2011) [hereinafter Order 745]. Where Order 719 gave consumers the option to participate in wholesale demand response markets if permitted by their States, Order 745 set the price the electricity generator must pay consumers for *not* consuming electricity. *Id.* Specifically, Order 745 mandates that "negawatts" of non-use *must* be bought and sold at the same price as megawatts of actual produced electricity. Order 745 at ¶¶ 1–4. In effect, then, by setting a *retail* rate, FERC seeks through Order 745

to regulate *retail* transactions—which Congress has expressly said FERC may not do.

"When the Constitution was adopted, one of the key compromises made by advocates of a stronger national government was that the new federal system would adequately preserve state power and state interests." Jacobs, *supra*, at 931. By using administrative authority to invade traditional, statutorily protected State prerogatives, federal agencies have violated that compromise.

II. Any Ambiguity Regarding Who Has Jurisdiction to Regulate Demand Response Should Be Resolved in Favor of the States

In light of the plain text of the Federal Power Act and States' traditional regulation of retail electricity sales, the Court has long observed a "bright line" between federal and State jurisdiction over the Nation's electricity transactions. *Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 215–16 (1964). Order 745 crosses that line. FERC's own definition of "demand response" is "a reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy." 18 C.F.R. § 35.28(b)(4). The only "customers" who actually "consume" electricity are retail customers; wholesale customers simply buy

electricity for resale. Indeed, FERC admits as much: "Our focus here is on customers or aggregators of *retail customers* providing . . . demand response that acts as a resource in organized wholesale energy markets." Order 745 at ¶9. And by setting the rate at which those retail customers must be paid, FERC is plainly "regulating" retail transactions.

To the extent any ambiguity exists regarding FERC's and the States' respective authority, that ambiguity should be resolved in favor of the States. When Congress has gone to great lengths to honor the principles of federalism, the Court should not lightly defer to an agency's attempts to encroach on State authority. In the energy market, Congress has expressly drawn a jurisdictional line between two regulators: FERC and the States. In a dispute about which side of that line a regulatory action falls, this Court should not simply presume that Congress intended the administrative agency to be the arbiter of the States' jurisdiction when ambiguity arises. Indeed, the Constitution's federal structure requires that the statute should be interpreted in a manner that preserves State authority.

A. This Court should not defer to agency attempts to regulate in a field Congress expressly reserved to the States

Chevron deference "is not accorded merely because the statute is ambiguous and an

administrative official is involved." *Gonzalez v. Oregon*, 546 U.S. 243, 258 (2006). Rather, *Chevron* deference is premised on the assumption that when Congress has created a regulatory regime ambiguous as to particular applications, it has implicitly delegated to the agency administering that regime the authority to resolve those ambiguities within the bounds of reason. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984); *see also City of Arlington v. F.C.C.*, 133 S. Ct. 1863, 1869 (2013).

That assumption loses its validity when Congress has expressly divided authority between two regulators and the dispute concerns whether a regulatory action is appropriately within the jurisdiction of one regulator or another. *See Salleh v. Christopher*, 85 F.3d 689, 691–92 (D.C. Cir. 1996). Absent clear statutory language or another independent interpretive principle, there is no reason to assume Congress impliedly removed from the courts the prerogative to judge the winner in a fight about the precise location of the border separating administrative realms.

Thus, courts of appeals have refused to extend *Chevron* deference to single agency interpretations within a jointly regulated regime. These courts have "never deferred where two competing governmental entities assert conflicting jurisdictional claims," instead choosing to exercise independent interpretive judgment in a "jurisdictional turf war."

Hunter v. F.E.R.C., 711 F.3d 155, 157 (D.C. Cir. 2013) (internal marks and citations omitted). "The alternative would lay the groundwork for a regulatory regime in which either the same statute is interpreted differently by the several agencies or the one agency that happens to reach the courthouse first is allowed to fix the meaning of the text for all." *Rapaport v. Dep't of Treasury*, 59 F.3d 212, 216–17 (D.C. Cir. 1995). This is true even when there is not yet any conflict between formal regulatory interpretations because there is no "reason to believe that the congressional delegation of administrative authority contemplates such peculiar corollaries." *Id.* at 217; *see also Chao v. Cmty. Trust Co.*, 474 F.3d 75, 85 (3d Cir. 2007) ("The mere fact that there could be conflicting regulations should preclude *Chevron* deference.").

Refusing to defer to a federal agency is especially appropriate where Congress has deliberately divided regulatory authority between a federal agency and the States. *See Solid Waste Agency of N. Cook Cnty. v. Army Corps of Eng'rs*, 531 U.S. 159, 174 (2001) [hereinafter *SWANCC*] (rejecting "request for administrative deference" when "Congress chose to recognize, preserve, and protect the primary responsibilities and rights of States" in a regulatory regime). In a case such as this, this Court has never "applied such a deferential standard to an agency decision that could so easily disrupt the federal-state balance." *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 41 (2007) (Stevens, J., dissenting).

"[A]dministrative agencies are clearly not designed to represent the interests of States," so "when an agency purports to decide the scope of federal pre-emption, a healthy respect for state sovereignty calls for something less than *Chevron* deference," if any deference at all. *Id.* (citations omitted).

To be sure, when Congress "explicitly supplants state authority" in granting an agency power within a regulatory vacuum, this Court has deferred to an agency's interpretation of its own statutory jurisdiction. *City of Arlington*, 133 S. Ct. at 1873. In that case, state power emerges only from default presumptions that sound because of Congressional silence. But here, Congress has *divided* regulatory authority between the agency and the States, explicitly choosing to give the agency power over one realm and to preserve, protect, and promote State power in another realm. *See* Part I, *supra*. *Both* the agency and the States have expressly recognized power to police market actors within this framework. *See, e.g.*, 16 U.S.C. § 813. In such statutory schemes, Congress's delineation of state power "was deliberate" and "not inadvertent[,]" making "sure its intent could not be mistaken by adding the explicit prohibition[s]" on agency encroachment and providing a "line [in] the statute" that is "clear and complete." *Panhandle E. Pipe Line Co. v. Pub. Serv. Comm'n of Ind.*, 332 U.S. 507, 516–18 (1947). Because Congress here has "cut sharply and cleanly" between the respective jurisdictions of the agency and the States, *id.*, the Court should not presume

Congress intended for one of those two powers—the agency—to be the arbiter of where the divide lies.

Moreover, *Chevron* deference is of questionable validity in a constitutional structure separating powers horizontally between the three branches of the federal government. *See* Philip Hamburger, *Is Administrative Law Unlawful?* 284–321 (2014). When Congress has delegated regulatory authority to *multiple* governmental bodies, judicial abdication of interpretive power to a *single* executive agency without express command of the Legislature may well be constitutionally intolerable. Add to this house of cards the weight of the vertical separation of powers concerns brought by Executive conflict with Congressionally sanctioned State prerogatives and the system of judicial deference to an agency's resolution of questions of law must collapse. This Court should avoid such constitutional perils, as well as unjustified assumptions about Congressional intent, by refusing to extend deference to FERC in this case.

B. Jurisdictional ambiguity should be resolved in favor of preserving traditional and expressly recognized State power

"[B]ecause the States are independent sovereigns in our federal system," this Court has "long presumed that Congress does not cavalierly pre-empt" state power. *Medtronic v. Lohr*, 518 U.S. 470,

485 (1996) (citations and alterations omitted). Accordingly, statutory interpretation "start[s] with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Id.* (citations and alterations omitted).

Even if this presumption is not applicable in a case such as this, countenancing agency encroachment on State sovereignty requires this Court "to be *certain* that Congress has conferred authority on the agency." *New York* v. *F.E.R.C.*, 535 U.S. 1, 18 (2002) (emphasis added). Concerns about the operation of the federal system are "heightened where the administrative interpretation alters the federal-state framework by permitting federal encroachment upon a traditional state power." *SWANCC*, 531 U.S. at 173. In the absence of certainty about agency authority, a healthy respect for our federalism justifies resolving ambiguity in favor of preserving State prerogatives, especially where Congress has explicitly chosen to recognize, preserve, and protect State power within a regulatory regime.

The central question in this case is whether Congress intended for rules setting compensation to incentivize reductions in retail demand to be within the jurisdiction of FERC or the States. The majority in the court below correctly held that this matter was clearly within the States' power. But if this Court instead determines, like the dissent below,

that the answer to this question is ambiguous, *Elec. Power Supply Ass'n*, 753 F.3d at 227, respect for our federal structure should resolve that ambiguity in favor of preserving traditional and expressly recognized State authority. Either way, the judgment below should be affirmed.

III. Order 745 Improperly Mandates a One-Size-Fits-All Federal Solution to Energy Problems Better Addressed by States

As discussed in Parts I and II, State jurisdiction over retail electricity sales is consistent with historical practice, statutory mandate, and the spirit of our federal system of government. What is more, it is good public policy. States use their regulatory authority to adopt the retail pricing system that best suits the needs and desires of their residents, taking into account geographic, socioeconomic, infrastructure, and cultural conditions. For some States, that has meant adopting the sort of free-form dynamic pricing system that FERC wants to see nationwide. But other States still follow the traditional fixed-rate approach, believing its stable predictability is better for consumers. *See* U.S. Energy Info. Admin., U.S. Dep't of Energy, Smart Grid Legislative and Regulatory Policies and Case Studies (Dec. 12, 2011) at 6–7 tbl. 3; *see also* FERC Staff Report, *A National Assessment of Demand Response Potential*, at 189 (June 2009). Congress long ago determined such regulatory diversity is

desirable, and FERC has no authority to homogenize it. Unfortunately Order 745, by increasing the demand response bounty to market-distorting levels, threatens salutary State regulatory hegemony over the generation and retail sale of energy.

A. State PUCs serve important public interests relevant to demand response

Since their inception, State PUCs have been charged with ensuring that electric utilities provide retail consumers with reliable service at a reasonable price. *See, e.g.*, *Office of Util. Consumer Counselor v. Pub. Serv. of Ind., Inc.*, 463 N.E.2d 499, 503 (Ind. Ct. App. 1984) (finding that "[t]he [Indiana PUC]'s purpose is to insure that public utilities provide constant, reliable and efficient service to its customers . . . ."); *cf.* Ind. Code § 8-1-2-4 ("Every public utility is required to furnish reasonably adequate service and facilities."). To that end, PUCs have traditionally set and fixed retail rates so consumers are not at the mercy of drastic price fluctuations and generators can still receive a fair rate of return.

The rate approval process illustrates how PUCs work to protect consumers and generators alike. If an electricity supplier wants to increase retail rates it must seek approval from the state PUC. For example, in Indiana, a petition to modify or establish a new electric rate must be filed with the Indiana Utility Regulatory Commission (IURC). Ind. Util.

Regulatory Comm'n, *Rate Case Process*, *available at* http://www.in.gov/iurc/2627.htm (last visited Aug. 29, 2015). The ensuing twelve- to eighteen-month process is adversarial as between the supplier, the Indiana Office of the Utility Consumer Counselor (OUCC), and other intervenors.[4]

After reviewing all the evidence from these competing interests, the Commission issues an order establishing "a level of rates and charges sufficient to permit the utility to meet its operating expenses plus a return on investment which will compensate its investors." *Citizens Action Coal. of Ind., Inc. v. Pub. Serv. Co. of Ind., Inc.*, 612 N.E.2d 199, 201 (Ind. Ct. App. 1993). A rate "must be nondiscriminatory, reasonable, and just" to consumers as well as sufficiently revenue-generating to permit the utility

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[4] The OUCC was created by the Indiana General Assembly in 1933 to "appear on behalf of ratepayers, consumers, and the public" in hearings before the IURC, Ind. Code § 8-1-1.1-4.1, and in that role saves ratepayers hundreds of millions of dollars annually. Indiana Office of Util. Consumer Counselor, 2014–2015 Annual Report at 2, *available at* http://www.in.gov/oucc/files/2014-2015_OUCC_Annual_Report.pdf (noting that, from July 2014 through June 2015, the OUCC helped to save ratepayers $392.1 million); *see also In re Petition of Indiana Michigan Power Company, an Indiana Corporation, for Authority to Increase Its Rates and Charges for Electric Utility Service*, Cause No. 44075, 2013 WL 1180842 (Ind. Util. Reg. Comm'n May 14, 2014) (ordering an increase of about 50% less than the utility requested).

to pay maintenance and operating costs, taxes, and other expenses. Ind. Code § 8-1.5-3-8.

Through procedures such as these, State regulators take the long view when balancing the competing interests of energy producers and consumers. Their efforts not only protect consumers from wild market fluctuations, but also ensure that producers have adequate incentives to generate sufficient energy and invest in capital improvements.

B. States are best situated to determine which if any demand response programs are right for their consumers

State governments have a greater familiarity with the concerns of their resident electricity consumers and generators. Thus, they are best suited to determine whether and how to implement dynamic pricing and demand response at the retail level so as to maximize benefits and prevent undesirable results like over-incentivizing non-use and under-incentivizing production. And especially in traditionally regulated States, direct consumer bidding of demand response into wholesale markets creates serious concerns. These concerns have led some States to impose restrictions on direct consumer participation in wholesale markets—restrictions that should be respected.

1. Traditionally regulated States have determined they can best serve their residents by granting monopolies to local electrical utilities, thereby ensuring service is efficient, economical, and reliable. *See, e.g.*, Ind. Code § 8-1-2.3 *et seq*. (establishing service areas for electric utilities). State PUCs then regulate the utilities to ensure, among other things, that they are able to meet retail demand in their areas. IURC Cause No. 43566 at 43. These regulations frequently include "tariffs, special contracts and programs designed to foster customer demand response." *Id.* And most importantly, they are adopted through open and transparent regulatory proceedings by a PUC that is "fully informed of utility costs, cost of service allocations, and risk" so as to "properly balance[ ] the benefits and costs for all utility customers." *Id.* at 44.

Direct consumer participation in wholesale markets has the potential to upset this carefully crafted regulatory plan in myriad ways. At a hearing before the Indiana's PUC on whether direct consumer participation in wholesale markets was right for Indiana, a representative of the Midwest ISO testified that in traditionally regulated States like Indiana, the practice could "interfer[e] with the utility's obligation to plan and serve under the traditional regulatory bargain." *Id.* at 5. Utilities in Indiana are required annually to submit their plans to meet demand in the coming year, and projected

use of resources like demand response must be included in those plans. *Id.* at 44. If consumers bid demand response directly into wholesale markets rather than going through their respective utilities, those utilities will lose access to demand resources they otherwise could have included in their plans. *Id.* Such utilities will then have to resort to "costly, additional generating capacity." *Id.* For this reason, Indiana's PUC determined "direct customer participation would introduce a significant degree of additional uncertainty into the evaluation of capacity needs and cost effectiveness"—essentially, that it would make it impossible for utilities to predict, plan for, and meet future demand. *Id.* at 45.

In addition to frustrating efforts to plan service for the future, retail customer participation in wholesale markets can result in unfair disparities in retail rates. A representative of Indiana Michigan Power, an electricity generator, pointed out that customers in traditionally regulated States do not pay "market" prices for their electricity; rather, they pay rates set by the State PUC. *Id.* at 7. But Order 745 would permit participating consumers to "resell" the electricity they do not use at the market price and thus "benefit from the arbitrage" while increasing costs for non-participating consumers. *Id.* Indiana's PUC concluded that "demand response should not result in uncertainties with respect to a negative impact to the cost of service to non-participating customers." *Id.* at 46.

Finally, Indiana's PUC concluded the State could obtain all the benefits of demand response by simply requiring retail customers to participate through their retail utilities: "[T]he resulting customer decrease in demand will reduce the demand for and the cost of wholesale purchased power, adding to the robustness of the competitive wholesale market" in the same way that direct participation would. *Id.* at 46.

2. For these and other reasons, some States have already come to the conclusion that permitting retail customers to bid demand response directly into the wholesale markets is neither appropriate nor consistent with state regulatory policies. As discussed *supra*, in an attempt to protect its regulatory prerogatives, Indiana's PUC has already been forced to prohibit retail customers from *directly* enrolling or participating in FERC's demand response programs. IURC Cause No. 43566 at 51.

This is not to say that Indiana disapproves of demand response *per se*. To the contrary, Indiana has a history of encouraging the use of demand response. *Id.* at 42 (noting it was undisputed "that there is an emerging opportunity to encourage and expand demand response), 44 (noting that IURC has permitted retail consumers to participate in utility-sponsored demand response programs "in docketed proceedings when fully informed of utility costs, cost

of service allocations, and risk"); *see also In re Petition of Steel Dynamics, Inc.*, Cause No. 43138 (Ind. Util. Reg. Comm'n July 7, 2007); *In re Joint Petition of Indiana Michigan Power Co. and I/N Tek*, Cause No. 43330 (Ind. Util. Reg. Comm'n Aug. 8, 2007); *In re Petition of AK Steel Corp.*, Cause No. 43503 (Ind. Util. Reg. Comm'n Sept. 3, 2008) (all approving the participation of particular industrial retail customers in PJM demand response programs).

But FERC's program threatens to undermine Indiana's holistic energy strategy. IURC Cause No. 43566 at 43. Indiana's own demand response reductions, already in place, are an "integral part" of "Indiana's short and long term energy and capacity planning." *Id.* at 45. Further, FERC's program could "introduce a significant degree of additional uncertainty" that could result in greater costs for all consumers. *Id.* at 46.

Similarly, Iowa's PUC has prohibited consumers from participating in FERC's program, reasoning that any benefit to participating consumers would be outweighed by the strong likelihood that non-participating consumers would then have to pay prices that were "discriminatory, unjust, and unreasonable or above the tariffed rate." *In re PURPA Standards in the Energy Independence & Sec. Act of 2007*, Smart Grid Report and Order Continuing Prohibition of ARCs, No. NOI-08-3, 2012

WL 2499366 at 3 (Iowa Dep't of Commerce Utils. Bd., June 25, 2012) (disallowing aggregation and forbidding retail customers from participating in wholesale demand response markets).

Michigan's PUC has also restricted consumers from participating in FERC's program. *Detroit Edison Co., Request to Initiate Investigation of Licensing Rules, and Regulations Needed to Address the Effect of the Participation of Retail Customers*, Mich. Pub. Serv. Comm'n No. U-16020, 2010 WL 5031082 at *7 (Dec. 2, 2010). Michigan's PUC stated that "[s]everal rate and reliability issues may arise when [consumer aggregators] participate in electric wholesale power markets." *Id.* at *6. Indeed, the Michigan PUC stressed the importance that, under demand response programs, "the rate paid is fair to participants as well as non-participants." *Id.*

Missouri's PUC likewise stated that "[t]here are significant questions that must be addressed" regarding the direct participation by retail consumers and aggregators in FERC's federal program. *In the Matter of an Investigation into the Coordination of State and Federal Regulatory Policies for Facilitating the Deployment of all Cost-Effective Demand-Side Savings to Electric Customers of All Classes Consistent With the Public Interest*, Order Temporarily Prohibiting the Operation of Aggregators of Retail Customers, No. EW-2010-018, 2010 WL 1422063 at *4 (Mo. Pub. Serv. Comm'n

Mar. 31, 2010). Missouri was uncertain what effect that participation by consumers in wholesale markets would have on: the LSE's revenue collection and budgeting process; the rate design; the long-term load forecasting process; participating and non-participating customers; and, the PUC's role in the regulation of participating consumers and aggregators. *Id.* In light of such uncertainty, Missouri's PUC prohibits consumers from participating directly in FERC's program. *Id.*

C. Order 745 compromises States' judgments about how best to integrate demand response

For these and other reasons, States have made policy judgments about how best to regulate retail sales, including demand response, and should not have those policy judgments second-guessed by FERC. As the Court of Appeals recognized, Congress intended for States to exercise just these sorts of independent judgments. This Court should not allow a federal administrative agency to override State policy decisions in contravention of both the plain language of the FPA and principles of federalism.

FERC has claimed that it is not intruding on state jurisdiction because Order 745 gives States the ability to "opt out" of the federal program. But that half-measure does not fix the jurisdictional problems with FERC's attempt to regulate retail sales. When

a State makes a decision about how best to regulate retail electricity sales, it should not be forced to "opt out" of a federal regime to protect the policy decision it has already made.

Moreover, as a practical matter, the "opt out" option does not work. For example, PJM Interconnection LLC, a wholesaler of electricity, has already established the model for circumventing State opt-out decisions. To comply with Order 719, PJM filed with FERC a proposed tariff to become an aggregator of retail customers in Indiana. Significantly, the tariff presumed that retail customers were eligible for participation in demand response unless a local distribution company determined otherwise. And, even though Indiana's PUC has issued orders prohibiting retail customers from participating directly in demand response programs without approval from the PUC, FERC *approved* PJM's tariff over Indiana's objection. *Ind. Util. Reg. Comm'n v. F.E.R.C.,* 668 F.3d 735, 738 (D.C. Cir. 2012). Now, because Order 745 has increased the bounty for consumer participation in wholesale markets, retail customers in traditionally regulated States have significantly greater incentives to circumvent State restrictions on demand response by signing up with aggregators who bid directly into the wholesale market—with the State PUC none the wiser.

Nor would affirmance here foreclose demand response at the retail level in traditionally regulated States. After all, Order 719 will ensure that retail customers may continue to bid their demand response directly into the wholesale market if their State permits that practice. And States will remain free to set the price for that demand response as they see fit (or not). Indeed, a State that really wants to encourage retail customers to bid their demand response directly into the wholesale markets could theoretically do so by setting the price higher than the market rate—which it could not do if Order 745 is permitted to stand.

Ultimately, the issue here is not whether demand response should have some function in determining the price of energy. It is instead whether FERC may override Congress's decision that each State must be left to choose the role of demand response for itself. Because of the Federal Power Act, traditionally regulated, vertically integrated utilities, with their geographic monopolies, integrated resource planning, and stable, state-refereed pricing, remain the backbone of the American energy market. FERC has no jurisdiction to induce bypass of that Congressionally approved regulatory model.

CONCLUSION

For these reasons, the decision below should be affirmed.

Respectfully submitted,

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