

As *Oneok* Drew Regulatory Line for Gas, So Does *EPSCA* for Electricity

Anthony Michael Sabino

Quite recently in these pages, we discussed a then-new Supreme Court decision carefully parsing the respective boundaries of federal oversight compared to state regulation of the natural gas industry.¹ But what about the electricity industry? Does not that segment of the energy sector deserve equal consideration from the Supreme Court on the crucial matter of who is authorized to regulate its operations?

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Fear not, for the justices have now accorded equal time to the electricity side of the equation. This newest proclamation from the Court sets forth clear boundaries of respective federal and state authority over the electricity industry, and it is remarkably symmetrical with the Court's earlier opining upon that same question with regard to the natural gas industry. Yet we do have concerns as to how the majority reached its ultimate holding in

Prof. **Anthony Michael Sabino**, partner, Sabino & Sabino, P.C., (anthony.sabino@sabinolaw.com) New York, specializes in complex business litigation in the federal courts, including oil and gas law and government regulation. He is also a professor of law in the Tobin College of Business at St. John's University and a special adjunct professor of law at the St. John's University School of Law, both in New York. He also serves on the board of the Nassau County (New York) Public Utility Agency.

that newest case and will share those concerns with you in due course.

JUSTICES' REASONING IN *EPSCA*

This latest decision is *Federal Energy Regulatory Commission v. Electric Power Supply Association*,² and its focus is a practice called "demand response." Demand response is simply explained as operators of wholesale electricity markets paying large consumers *not* to use electricity at times of peak demand. The strategy eases demand at the most stressful times for the grid, alleviates upward pressure on prices, and finally benefits the entire market by increasing the grid's reliability while simultaneously lessening the chance of overloads and overall systemic failure.

Before turning to the case itself, we must first review the fundamentals of electricity regulation as they have existed for nearly a century. Federal regulation of the wholesale market for electricity extends back at least to the 1920s, when the justices declared that the states could not constitutionally oversee what was undeniably an interstate business.³ Such power over interstate commerce is the exclusive bailiwick of Congress, pursuant to the Commerce Clause.⁴

The Court having thus established the constitutionality of federal regulation of the interstate electricity business, Congress followed up in 1935 by enacting the Federal Power Act (FPA) and creating an agency to administer the FPA's provisions. Today, that body is the Federal Energy Regulatory Commission (FERC), charged with responsibility to promulgate rules and regulations for, among other things, the wholesale electricity market.

As a long-standing counterpoint, the FPA mandates that regulation over the local aspects

of the electricity industry, particularly the retail sector, is left to the states. To be sure, this division of authority has remained relatively stable over the years, and, as mentioned earlier, mirrors the same division of authority for the regulation of the natural gas industry.⁵

Today, and at the heart of the upcoming case, FERC acted upon its authority to promote demand-response programs with the operators of the various interstate electricity grids. As indicated earlier, the benefits of demand response are obvious: during peak times, demand-response consumers drop off the grid, decreasing demand when it is most urgent, which likewise helps keep wholesale prices under control. At the same time, less demand means less stress on the interstate grids, at a time when they are most at risk of failure due to overload. Accordingly, FERC promulgated Order No. 719 in 2008, and followed up in 2011 with Order No. 745, each edict encouraging demand-response programs by interstate grid operators.

EPSA Objects, and Justice Kagan Objects to EPSA

Now let us examine the challenge.

An industry group, the Electric Power Supply Association (EPSA), objected to the new rules, claiming they usurped state authority. After all, these demand-response participants were consumers of electricity, and, by definition, denizens of the retail sector are beyond the purview of federal jurisdiction. The matter came before the Court for resolution.

Writing for the majority, Justice Elena Kagan found that the Court's analysis had to be divided into three parts. First, were these FERC rules truly confined to the wholesale market for electricity? Second, did the agency's demand-response rules unlawfully derogate state authority over the retail side of the industry? Third and last, no matter FERC's intentions, did the true impact of its rulemaking unlawfully extend to the retail market explicitly reserved for state domination?

Within FERC Authority

As to the first inquiry, Justice Kagan acknowledged that the agency not only had the right, but the obligation, to oversee the wholesale market. This included authority, as bestowed by the FPA, for FERC to exercise jurisdiction over any matter "affecting" wholesale markets.

Certainly, said the tribunal, the word "affect" could be misconstrued to make the agency's power almost limitless. Yet the majority assuaged any such concern, holding that the potentially global reach of that term was effectively counterbalanced by the word "directly" as the immediately preceding modifier.

In sum, FERC's jurisdiction was indeed confined to matters that directly impacted the wholesale market in electricity, and no more. That established, the Court was satisfied that the agency's demand-response rules were purposed to benefit interstate operators, by promoting better balancing of demand, stability in prices, and reliability in the spider web of power grids that crisscrosses the land.

Not a Power-Grab

The Court then addressed the second component of its tripartite inquiry: to wit, did the federal regulators' rulemaking overstep into the domain of the retail electricity market, an arena clearly left to the states to regulate? Here, the justices bowed to the inevitable truth of the electricity industry—indeed, all markets. As with all products, wholesale and retail marketplaces do not act in isolation from each other.

This truism is no less applicable to the energy sector, acknowledged the Court. Inevitably, FERC oversight of the wholesale market will have repercussions on the retail side of the business. Yet merely because there is some impact, opined Justice Kagan, it does not follow that state authority is automatically diminished. In the instant case, the Court had no difficulty in finding that FERC's support of demand response was lawful, because its aim was to impact the wholesale, not the retail, side of the industry.

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Moreover, the Court found adjacent support for this holding by proclaiming that there was never a hidden agenda by the agency to trespass into the states' rightful domain. No matter the ultimate impact upon the retail side, said the

justices, it was never part of FERC's calculus to aggrandize itself of power at the expense of local oversight.

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Notably, the majority allocated a fair amount of discussion to this part of its ruling, no doubt motivated by the fact that the opponents of demand response were insistent that FERC's true motivation here was to lure end-users to stand beneath the federal regulatory umbrella. Nonetheless, the Court found such an argument could not hold water.

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It was not the intention of the federal regulators to intrude upon state authority here, found the majority. One could never rationally interpret the agency's promulgations as infringing upon state authority to oversee local markets. After all, state regulators could always be proactive in taking steps to insulate their constituents from any negative consequences of demand response, say, by refusing to permit electricity providers from raising rates beyond what state authorities deemed appropriate.

The majority furthermore proclaimed that the agency's rulemaking was not "a Commission power grab," but rather a "market-generated innovation" directed toward maintaining an orderly and reliable wholesale market. Indeed, Justice Kagan made the pungent observation that demand response "falls within the sweet spot of FERC's statutory charge" to regulate this portion of the electricity industry.

FERC Had Not Transgressed

One decisional point was left for discussion. Did FERC's actions to promote demand response transgress the bounds of its authority, as delimited by Congress in the FPA all those decades ago, and did this incursion derogate

state power over the retail market? In this regard, demand-response critics had launched a rather far-ranging attack upon the federal regulators here, contending that the entire mechanism fell wholly outside the ambit of federal jurisdiction. Thus, FERC was making rules in an area where it completely lacked the authority to do so.

Once more, those arrayed in opposition renewed their allegation that demand response was but a crude artifice to entice end-users of electricity to abandon local regulation and place themselves under the protection of the federal overseers. Characterizing demand response as nothing more than FERC's attempt to sign on retail consumers as additional vassals of agency authority, the objectors derided the agency's rules as a clear subversion of the clearly defined limits of authority that Congress had imposed upon FERC and its predecessor agency decades ago.

The Court was quite unconvinced by these remonstrations. The majority reminds that state authority is explicitly restricted to regulating the retail sector. Certainly, demand response effectively links local consumers and interstate operators, after a fashion. Yet if federal oversight over such programs was ousted in favor of local regulation, this would produce the converse of what the opponents of demand response decried: an equally inappropriate intrusion of local authorities into the federally regulated wholesale market.

Such reasoning engenders yet another serious problem, noted Justice Kagan. If one takes the opposition's argument to its logical conclusion, the Court would have no alternative but to declare that neither federal nor state agencies can regulate demand response, and therefore such a device falls into some unregulated limbo.

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The justices refused to embrace such an unattractive and potentially disastrous outcome. Such a lack of supervision for this part of the electricity industry, with consequences wholly unpredictable and quite possibly dangerous, would not be countenanced.

The Court was constrained to point out that federal energy law is not so neglectful as to permit the creation of a regulatory vacuum over any aspect of an industry as important as the electricity sector. Quite to the contrary, national statutes have long provided for complementary schemes of federal and state oversight that work together to maintain orderly wholesale and retail markets for the mutual benefit of the electricity industry itself, as well as those it serves.

The majority held that the law's clear and pragmatic approach is to explicitly reserve the regulation of the wholesale component of the electricity industry to the federal side, while concomitantly preserving state dominion over the retail market. Accidental, let alone deliberate, gaps in the regulatory landscape were simply not contemplated by lawmakers decades ago, nor would they be condoned by the Court today.

Steadfast in maintaining what it found to be a clear reading of the FPA's provisos, and refusing to adopt an interpretation that would lead to illogical and conceivably dangerous results, the majority closed out its threefold analysis, concluding that there were ample grounds under each of the trio of its analytical points to uphold FERC's authority to promulgate rules that regulated demand response.

Nor Was FERC High-Handed

A final note: the opponents of demand response made one last gambit in their quest to win the day.

They raised the customary argument that, as a matter of administrative law, the agency had acted in an arbitrary and capricious matter in devising these demand-response rules in the first instance. It is well-known that long-standing precepts of federal administrative law, which governs and restricts agency action, have long provided grounds for overturning regulatory proclamations when agency bureaucrats act in a high-handed and unjustifiable manner.

The Court disposed of this last, almost obligatory, point with great alacrity. Finding nothing arbitrary or capricious in the enactment of these rules by FERC, the Court finally concluded its opinion, coming down squarely in favor of the agency's authority in this affair. And so, the *EPSA* Court declared that the demand-response rules promulgated by FERC were the result of that agency's lawful exercise

of its power to regulate wholesale markets, and the agency had done so without intruding upon the retail sector that has always been left to state regulation.

Scalia's Dissent Was That FERC Operated Outside of the FPA

While the above concludes our discussion of the majority holding, we cannot in good conscience end there. To be sure, we normally do not devote much discussion in these pages to the Court's dissenting opinions. Yet it is very important that we make an exception here, because both the author of the dissent and the wisdom he imparted demand our careful consideration.

For in *EPSA*, the contrary opinion was authored by the late Justice Antonin Scalia (and joined by Justice Clarence Thomas). As this erudite dissent represents Justice Scalia's final words on the weighty matter of federal administrative agencies generally and the regulation of the electricity industry in particular, we pause to give the legendary justice his due.

As was his wont, Justice Scalia stood fast to one of the most fundamental propositions of his decades of jurisprudence; a statute means what it says and says what it means. Translating that principle into action for the case at hand, he first asserted that the plain language of the FPA strictly delimits FERC oversight to wholesale transactions in electricity only. By definition, absent proof that a transaction falls squarely within the wholesale sector, the agency is bereft of authority to regulate the action in question.

Justice Scalia therefore contended that the majority here "inverts the proper inquiry" by even asking if FERC's rulemaking on demand response impacted the retail sector of the electricity industry. In his usual fine words, Justice Scalia insisted that the agency first prove the thing it seeks to regulate is clearly within the domain of the wholesale sector it holds sway over before it promulgates rules affecting the same.

The methodology thus established, Justice Scalia once again took the plain text of the law in hand to declare the following: FERC is only empowered to regulate resellers of electricity (i.e., the wholesale market). Yet those partaking in the agency's efforts to promote demand response are, in fact, always *consumers*, but *never*

resellers, of electricity. It is the identity of the parties contracting to demand response, not the market they do business in, that is determinative here. “Or so, at least, says the statute,” Justice Scalia wryly observed.

The interlock between the controlling statutes was cemented by Justice Scalia in the following way: Congress gave FERC power to regulate only the wholesale component of the electricity industry, while concomitantly forbidding the agency to trespass into the parallel retail market.

By definition, demand-response participants are consumers, and therefore it is beyond argument that they reside well outside the ambit of FERC’s jurisdiction. Thus, contended Justice Scalia, any attempt by the agency to promote demand response via rulemaking was an unauthorized intrusion into territory the federal regulators were statutorily prohibited from entering.

In this, one of his last exercises on the Supreme Court, Justice Scalia closes with his legendary command of the written word. Criticizing the majority’s reasoning as an “extravagant and otherwise-unheard-of method of establishing regulatory jurisdiction,” he called upon his brethren to eschew such hazardous misreading of explicit statutory provisions, urged them to ignore the “[a]larmist hyperbole” propounded over supposedly inflicting damage to agency authority, and encouraged them to stay a course of statutory construction solidly grounded upon a law’s clear words and their plain meaning. And so spoke the great man.

Regarding this latest extrapolation from the Supreme Court, while we are tempted to categorize *EPSA* as a simple parsing of federal versus state authority over the electricity industry, we must resist such a facile analysis. Certainly, we concur with the bottom-line result that this decision will surely encourage. Demand response is unquestionably beneficial, as it works to decrease demand for electricity during peak periods, and thereby relieve stress upon electrical grids at a time when they are most in danger of collapsing from demands they cannot meet.

We can understand the Court’s validation of FERC’s exercise of authority here, first, because it clearly does not offend state authority over the retail market for electricity. Similarly, the agency’s rulemaking promoting demand

response was unquestionably aimed at assisting the wholesale market, by easing the burden of the grid operators. Because said entities inarguably fall within FERC’s purview, one can easily reconcile this validation of federal jurisdiction for reason of its impact upon interstate actors.

But rarely does the end justify the means, particularly in matters of the law, and that is what concerns us here. Justice Scalia states it well in the plainspoken yet forceful dissent that will stand as one of his greatest legacies. Those who sign up for demand response are consumers of electricity. It is beyond reality that they operate wholly within the retail sector of the electricity industry; equally true, in no way can they be deemed to operate on the wholesale side of the boundary so carefully drawn by Congress in the long-standing FPA, as left unaltered by equally vintage Supreme Court precedent.

We are compelled to agree with Justice Scalia in these matters. Yes, demand response is a good thing. But no, it is not properly a matter for federal regulators. The dissent’s mode of analysis is much more in keeping with interpreting these federal regulatory statutes in accordance with their plain meaning.

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Yet the Supreme Court has spoken, so that is that. Notwithstanding, we sincerely hope that those the great man left behind on the nation’s highest court shall take heed of his sage words, and in the future the justices shall draw the line for federal jurisdiction over all components of the energy industry with the great care for the statutory text that Justice Scalia so clearly emoted upon in this case, and many others. 

NOTES

1. Sabino, M. A. (2016, January). Supreme Court clarifies federal versus state authority over natural gas. *Natural Gas & Electricity*, 32(6), 1–7 (discussing *Oneok, Inc. v. Learjet, Inc.*, 575 U.S. ____ 135 S. Ct. 1591 (2015)).
2. 577 U.S. ____ 136 S. Ct. 760 (2016) (“*EPSA*”).
3. *Public Utility Commission of R.I. v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).
4. CONST. Art. I, Section 8, cl. 3. See also *United States v. Lopez*, 514 U.S. 549 (1995).
5. See Note 1.