

Energy Litigation Alert

DC Circuit Vacates FERC Rule Mandating Uniform Energy Rates for Demand Response

Appeals Court Says Rule Goes Too Far, Encroaching on the States' Exclusive Jurisdiction to Regulate Retail Markets

In a decision with significant implications for the Federal Energy Regulatory Commission, state commissions and market participants, the U.S. Court of Appeals for the D.C. Circuit held that a FERC rulemaking impermissibly regulated in an area reserved to the states by setting compensation for demand response resources participating in regionally organized wholesale energy markets. *Electric Power Supply Association v. FERC*, No. 11-1486 (D.C. Cir. May 23, 2014).

In a 2-1 opinion, the court held that “[d]emand response—simply put—is part of the retail market.” Slip Op. at 11. Thus, according to the court, Order No. 745 impermissibly intrudes on states’ exclusive jurisdiction to regulate retail transactions by “draw[ing] demand response resources into the [federally regulated wholesale] market and then dictat[ing] the compensation providers of such resources must receive.” *Id.* at 12.

Limitations on FERC’s Jurisdiction

FERC argued that it could regulate demand response compensation because demand response affects the wholesale energy market, and sections 205 and 206 of the Federal Power Act authorize FERC to ensure that rules and practices “affecting” rates in connection with wholesale transactions are just and reasonable. The court rejected FERC’s interpretation of its FPA authority, finding that FERC’s rationale “has no limiting principle.” Slip. Op. at 8. As the court put it, “Without boundaries, §§ 205 and 206 could ostensibly authorize FERC to regulate any number of areas, including the steel, fuel, and labor markets.” *Id.*

The court further explained that FPA section 201 limits FERC's authority to matters that are not subject to regulation by the states, and section 205 and 206's broad "affecting" language does not override that limitation.

But even if FERC had power to implement its rulemaking, the court would have vacated Order No. 745 as arbitrary and capricious. According to the court, FERC failed to meaningfully consider arguments that the compensation rate was excessive.

The court noted that FERC has permitted demand-side resources to participate in organized wholesale markets for more than a decade and has issued dozens of orders on demand response participation in the regional markets. *Id.* at 3–4. However, the court did not address the validity of FERC's earlier orders in light of its decision regarding Order No. 745.

Dissent Would Have Affirmed FERC's Rule

Senior Circuit Judge Edwards would have affirmed FERC's authority to regulate demand response. According to Judge Edwards, the court should not be in the business of divining whether demand response resources should be regulated by the states based on a finding that electric consumption falls on the retail, rather than the wholesale, side of the jurisdictional line. In his view, demand response is not unambiguously a matter of retail regulation and section 201 does not make clear that Congress intended to foreclose FERC from regulating demand response resources that have a direct effect on FERC-regulated markets.

Conclusion: Implications for State Commissions

If left undisturbed or if affirmed by an *en banc* panel or by the Supreme Court, the D.C. Circuit's decision will have significant and lasting implications for state regulators. In the meantime, states with robust demand response programs for reliability or peak-load shaving may need to take decisive action now to ensure the continuation of these important programs. One company has already filed a complaint asking FERC to exclude demand response suppliers from participating in the PJM regional capacity market. If FERC accedes, significant contractions in competitively priced capacity supplies that are otherwise available to ensure system reliability in the mid-Atlantic region may be expected. Moreover, if similar complaints are filed with respect to other FERC-regulated regional wholesale markets, such supply contractions may affect electric reliability for states across the country.

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