Supreme Court walks energy policy tightrope as it addresses federalism and states' rights

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A rare trio of near-simultaneous Supreme Court energy cases is providing considerable drama as the Court weighs competing claims of federal and state power to control energy policy. In resolving them, the Court is likely to shape the future of energy project development, renewable energy, and possibly even the Court's eventual review of the Obama administration's Clean Power Plan.

With Congress in stalemate over energy policy, particularly on issues relating to climate change, clean energy, energy efficiency, and demand reduction, the states have stepped forward to fill the void. States are legislating and regulating to support renewables and new clean (natural gas-fired) power generation as replacements for old and dirty coal plants, and are examining the limits of natural gas pipeline pricing power. At the same time, the Federal Energy Regulatory Commission (FERC) is also trying to innovate—for instance, by supporting demand response programs that pay customers to avoid using electricity during periods of peak demand.

Who should lead this effort—the states or FERC? The Supreme Court is walking a tightrope as it considers these issues. With two of the three energy cases now decided, the Court appears to be supporting a new spirit of cooperative federalism, under which the federal government can regulate in matters directly affecting wholesale power and gas markets, while states retain authority over retail energy sales and matters that indirectly affect wholesale markets.

Negawatts equal megawatts

The Court's most recent decision, *Federal Energy Regulatory Commission v. Electric Power Supply Ass'n*, ___ S. Ct.___, No. 14-840, (U.S. Jan. 25, 2016), responds to a rule FERC issued in 2010 under the Federal Power Act (FPA), known as Order No. 745, that requires wholesale power market operators to pay electric consumers for their commitments *not* to use power at certain key times (such as when demand is particularly high). Order No. 745 required that these payments for not using electricity be equal to the rates wholesale power generators are paid for *generating* electricity. FERC thus sought to establish the principle that "negawatts" equal megawatts.

Wholesale generators, seeing FERC's position as a threat to their market, challenged Order No. 745. First, they argued, FERC has no jurisdiction under the FPA over the electric consumption of end-use customers at their homes or places of business; such retail use is the province of the states. Second, they argued that FERC acted arbitrarily and capriciously by determining that negawatts equal megawatts. After all, why should customers that make the inexpensive decision to *stay out* of the market be paid the same amount as companies that invest millions to erect the massive machinery that actually generates electricity?

In a 6–2 decision (Justice Alito recused himself), the Court sided with FERC, reasoning that Order No. 745 only *indirectly* impacted retail market prices; the order's direct effect was on wholesale markets, thus putting it within FERC's jurisdiction. Justice Kagan, writing for the majority, said that FERC had "amply explained how wholesale demand response" helps to achieve the FPA's dual core objectives—to protect "against excessive prices" and ensure "effective transmission of electric power." The Court, she wrote, would not "read the FPA, against its clear terms" and overhaul demand response when it so clearly permits FERC "to fulfill its statutory duties of holding down prices and enhancing reliability in the wholesale energy market." Given the FPA's purposes (which no one disputed), the Court was unpersuaded by arguments that FERC had overstepped its jurisdiction and was impinging on states' rights to regulate retail power prices. As Justice Kagan wrote, "although (inevitably) influencing the retail market too, [Order No. 745] does not intrude on the States' power to regulate retail sales." She added that, "in choosing a compensation formula, the Commission met its duty of reasoned judgment. FERC took full account of the alternative policies proposed, and adequately supported and explained its decision."

Natural Gas Act and states' antitrust authority

The second case, *Oneok, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591 (2015), involved states' efforts under state antitrust laws to investigate wholesale natural gas sellers' direct sales to large industrial customers. In *Oneok*, the Court held that the Natural Gas Act (NGA)—a statute similar to the FPA in many respects—does not preempt a state antitrust investigation of sales of natural gas. The Court nonetheless observed that "Congress occupied the field of matters relating to wholesale sales and transportation of natural gas in interstate commerce."

The key difference for preemption purposes was the distinction between "measures aimed directly at interstate purchasers and wholesale for resale, and those aimed at" subjects left to the states. Where a state law can be applied to nonjurisdictional (i.e., state's realm) as well as jurisdictional (i.e., FERC's realm) sales, the Court will only find preemption where the matter falls within the preempted field. Antitrust laws, the Court said, like blue sky laws, are not aimed at natural gas companies in particular, but rather at all businesses in the marketplace. This broad applicability, not aimed at wholesale natural gas sellers, convinced the Court to find no preemption.

Can states support wholesale power plant development?

The final cases, yet to be resolved, are in ways the mirror image of *FERC v. Electric Power Supply Ass'n*, this time testing whether *states* ventured too far into FERC's exclusive realm under the FPA. These cases, which were scheduled to be argued on February 24, 2016, deal with states offering selected power plant developers guaranteed wholesale capacity payments no matter what they actually produce. *Hughes v. Talen Energy Mktg.*, No. 14-614, and *CPV Md. v. Talen Energy Mktg.*, No. 14-623. The key issue is whether the FPA preempts states from offering guaranteed contract prices to build wholesale power plants in organized competitive wholesale power markets. Both the Third and Fourth Circuits determined that similar procurement programs in two states were preempted by the FPA.

Given the lack of a circuit split, lawyers involved in the *Talen Energy* cases were surprised when the Supreme Court granted certiorari only five days after oral argument in *Electric Power Supply Ass'n*. Some have speculated that Justice Alito's recusal in that case may have been behind the surprise grant, reasoning that because a 4–4 split was possible in *Electric Power Supply Ass'n*, the Court wanted to assure itself of another crack at the FPA this term to define the boundaries of cooperative federalism in electricity policy. Time will tell.