

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 FEDERAL ENERGY REGULATORY :

4 COMMISSION, :

5 Petitioner : No. 14-840

6 v. :

7 ELECTRIC POWER SUPPLY :

8 ASSOCIATION, ET AL. :

9 - - - - - x

10 and

11 - - - - - x

12 ENERNOC, INC., ET AL., :

13 Petitioners : No. 14-841

14 v. :

15 ELECTRIC POWER SUPPLY :

16 ASSOCIATION, ET AL. :

17 - - - - - x

18 Washington, D.C.

19 Wednesday, October 14, 2015

20

21 The above-entitled matter came on for oral

22 argument before the Supreme Court of the United States

23 at 11:07 a.m.

24 APPEARANCES:

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1 Department of Justice, Washington, D.C.; on behalf of
2 Federal Petitioner.

3 CARTER G. PHILLIPS, ESQ., Washington, D.C.; on behalf of
4 private Petitioners.

5 PAUL D. CLEMENT, ESQ., Washington, D.C.; on behalf of
6 Respondents.

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P R O C E E D I N G S

(11:07 a.m.)

CHIEF JUSTICE ROBERTS: We'll hear argument next in Case 14-840, the Federal Energy Regulatory Commission v. The Electric Power Supply Association and the consolidated case.

General Verrilli.

ORAL ARGUMENT OF GEN. DONALD B. VERRILLI
ON BEHALF OF THE FEDERAL PETITIONER

GENERAL VERRILLI: Mr. Chief Justice, and may it please the Court:

The Federal Power Act expressly authorizes FERC to regulate the process that sets wholesale rates for electricity, and that is exactly what FERC's wholesale demand response rules do.

Demand response is a resource that is bid into the wholesale auction, and the wholesale market operators that run those auctions rely on the bids to balance wholesale supply and demand, to set wholesale rates, and they particularly rely on those bids in periods of peak demand to avoid price spikes and to avoid blackouts and brownouts.

JUSTICE KENNEDY: If there were a student in Economics I, it seems to me that he would conclude and his professor would conclude that wholesale affects

1 retail, retail affects wholesale, they're interlinked,
2 which means you win the case, except that the statute
3 makes a distinction. We have to make a distinction.

4 Can you tell us what the distinction is that marks the
5 end of Federal power and the beginning of local power?

6 GENERAL VERRILLI: So I -- I have several
7 answers to that, Justice Kennedy.

8 First, we completely agree that what -- any
9 action that FERC takes at the wholesale level in some
10 sense is going to affect the retail market. All things
11 equal, if FERC sets -- FERC will set a higher wholesale
12 rate, there is going to be a higher retail price. But
13 that can't be a basis -- those kinds of effects can't be
14 a basis, for denying FERC's jurisdiction.

15 And the case I would particularly point Your
16 Honor to is the Mississippi Power case. Now, there was
17 a case in which what FERC did was conclude that a
18 utility could recover at wholesale its investment in a
19 nuclear power plant. And what the Court held in
20 Mississippi Power was that that had the effect of
21 denying the State regulator the ability to deny that
22 utility recovery of those costs in the retail rates,
23 even though under State law they would have been
24 imprudent costs and not recoverable. That was a very
25 direct effect on the exercise of State regulatory

1 jurisdiction, which you do not have here, by the way, so
2 I think a fortiori, this is certainly permissible under
3 the rationale of Mississippi Power.

4 JUSTICE SCALIA: I find that a pretty fuzzy
5 line, "very direct effect." I -- it seems to me that
6 there is a distinction between affecting retail rates,
7 which, as Justice Kennedy has pointed out, always
8 happens, and using -- using effect upon retail rates as
9 a means of regulating wholesale rates. And the argument
10 here is that that is what has occurred, that
11 effectively, FERC has raised the retail price during
12 peak hours because somebody who wants to purchase at
13 retail during peak hours not only pays -- you know, has
14 to forgo the benefit that that person would otherwise
15 get from FERC's program. That raises the price at
16 retail, and that is the means of achieving what FERC
17 wants to achieve.

18 Yes, FERC has the -- has the power to
19 regulate wholesale rates. But -- but, the argument is,
20 not through the fiddling around with retail rates, which
21 is what is asserted is happening here.

22 GENERAL VERRILLI: So -- I think three
23 points to be made in response to that argument, Justice
24 Scalia. First, the -- the authority that's exclusively
25 reserved to States by Section 824(b) of -- of the

1 Federal Power Act is the authority over retail sales.
2 Every retail sale that occurs in the regime in the -- in
3 FERC's -- under FERC's wholesale demand response regime
4 is a retail sale that will occur at the rate that the
5 State regulator has set, and under the terms and
6 conditions that the State regulator has set, every
7 single sale that occurs that is true about.

8 Second, what they have said is that this
9 changes the effective rate. But what I would say in
10 response to that, Your Honor, is that if I go out and
11 buy a Ferrari for \$100,000, everybody thinks that the
12 price of the Ferrari is \$100,000. Nobody thinks that
13 the price of the Ferrari is actually \$107,000 because
14 I'm foregoing the \$7,000 tax credit I can get if I
15 bought an electric car. The rate is what it is. It's
16 \$100,000. And here, the rate is what it is.

17 And third, the point I would make, it seems
18 to me, it's a very odd argument to say that what FERC's
19 rules do here is increase the retail price. What FERC's
20 rules do is drive the retail price down by driving the
21 wholesale price down by very considerable amounts in
22 peak periods. This is -- this is a system that results
23 in lower rates for retail consumption.

24 JUSTICE SCALIA: Well, yes, ultimately, but
25 the question is whether that is achieved by the means of

1 directly managing retail rates. And you say this does
2 not. What if FERC --

3 GENERAL VERRILLI: Those --

4 JUSTICE SCALIA: -- had sufficient funds
5 available that it could pay people to not purchase
6 electricity during peak hours? It just said, you know,
7 we'll give you so much per day not to use more than X
8 amount of electricity during peak hours. Would that --
9 would that be within FERC's powers?

10 GENERAL VERRILLI: I think that would be a
11 harder case than this one because all of the conduct
12 that FERC regulates here occurs in the wholesale market.
13 All of it. The -- this is about what bids can be
14 accepted into the wholesale market, what --

15 JUSTICE SCALIA: It -- it's the difference
16 between turning over money to these retail purchasers
17 and simply depriving retail purchasers of a benefit that
18 they could otherwise obtain in the wholesale market.

19 GENERAL VERRILLI: I -- I think this is a
20 more straightforward case, because all of the conduct
21 that FERC regulates occurs in the wholesale market, all
22 of the actors are regulated in their role in the
23 wholesale market, and FERC's purpose in this situation
24 is to achieve lower wholesale rates and to allow and to
25 prevent -- allow wholesale operators to prevent

1 blackouts and brownouts in their --

2 CHIEF JUSTICE ROBERTS: But it's still based
3 on direct price regulation of the retail rate. It may
4 be the same point as your Ferrari hypothetical, but
5 if -- if FERC is basically standing outside McDonald's
6 and saying, we'll give you \$5 not to go in, and the
7 price of the hamburger is \$3, somebody goes up there,
8 their -- the price of a hamburger is actually, I think
9 most economists would say, \$8, because if they give up
10 the \$5, they've still got to pay the \$3.

11 And your answer is, there's no impact on
12 what the States can do, because they can still say, no,
13 the price of the hamburger should be \$2, or it should be
14 \$4. The point is that -- that FERC is directly
15 affecting the retail price.

16 GENERAL VERRILLI: And I guess there's an
17 additional point to be made in response to that, Your
18 Honor, is that -- the -- here, of course, what FERC is
19 doing is saying, here are the rules by which the
20 wholesale market is going to operate, and if you come
21 into the wholesale market, these are the rules that will
22 apply to you.

23 But ultimately it remains up to the States
24 because FERC takes State law as it finds it here,
25 whether citizens of the State can go into the wholesale

1 market. They can only go into the wholesale market if
2 FERC -- if States agree that they can go into the
3 wholesale market. So it's very difficult to see that --

4 JUSTICE SCALIA: That -- that's interesting.
5 If FERC has this power, how can it strip itself of this
6 power by saying, we will not do this if the States don't
7 want us to do it?

8 GENERAL VERRILLI: Well, I think FERC
9 certainly has that authority in the course of deciding
10 what's a just and reasonable practice. And, in fact, I
11 believe that that's what the Court held in *New York v.*
12 *FERC* with respect to FERC's decision not to regulate
13 the -- the bundled element of transmission there because
14 it was concerned about jurisdictional overlaps. And
15 there FERC didn't exercise its regulatory authority at
16 all. And so it's a for --

17 JUSTICE SCALIA: That's quite different.
18 That's quite different from saying we're going to
19 exercise it unless you, the States, veto it. I don't
20 know that if -- if FERC really has that power. I don't
21 know how it can confer a veto on the States.

22 GENERAL VERRILLI: Well, it seems to me,
23 Your Honor, that that's not an argument that goes to
24 FERC's jurisdiction. That may be an argument, although
25 no one has made it in this case, that if FERC believes

1 that this practice is -- that this practice is required
2 to have a just and reasonable wholesale rate, that --
3 that FERC can't then let States opt out.

4 But, again, that seems to me to be a merits
5 issue, not a jurisdictional issue. And -- and again, I
6 think it's -- it's just incorrect under this Court's
7 holding in FERC v. --

8 JUSTICE SCALIA: No, I think it's goes to
9 whether FERC really thinks that it's meddling in -- in
10 retail rates.

11 GENERAL VERRILLI: No, Your Honor --

12 JUSTICE SCALIA: That's what it goes to in
13 my mind. I think it's an acknowledgment by FERC that,
14 in fact, you know, we are mucking around in an area
15 that's the State's area. And if the States don't want
16 us to do it, we won't do it.

17 GENERAL VERRILLI: I appreciate that, that
18 Your Honor dissented in New York v. FERC on a ground
19 very much like that. But the Court held that that was a
20 legitimate exercise of FERC's authority to decide what
21 just and reasonable practices were, to take that
22 jurisdictional overlap into account. And that's all
23 FERC has done here. It seems to me quite clear that
24 that is, under the logic of New York v. FERC,
25 permissible exercise of -- of FERC's authority.

1 And so in a situation, it seems to me, in
2 which what you've got is FERC taking State law as it
3 finds it, you really can't say that this is a
4 impermissible interference or a power grab or any
5 intrusion into State authority because the States
6 ultimately make the decision.

7 I -- in fact, I think the Federalism
8 argument is upside down here. This is a situation in
9 which what you have is a FERC rule that really is a
10 strong version of cooperative Federalism.

11 What FERC is saying here is that this is
12 policy that we think works, we think brings about
13 billions of dollars in consumer benefits by lowering
14 wholesale rates.

15 JUSTICE KENNEDY: Is it fair to say that
16 FERC is luring retail customers into the wholesale
17 market? And if that --

18 GENERAL VERRILLI: Yes, well, my friend
19 has -- my friend has used that term, but I think --

20 JUSTICE KENNEDY: And if that -- and if --
21 if -- well, if that were true, would that not be a --
22 a -- a serious problem for the government?

23 GENERAL VERRILLI: It's wrong as a matter of
24 history -- as a matter of history. It's wrong as a
25 matter of law. This -- this idea of wholesale demand

1 response was not FERC's idea. FERC didn't impose it on
2 the market, Justice Kennedy. This is a practice that
3 grew up organically out of the private actions of market
4 participants once the wholesale markets were
5 deregulated. It's exactly the kind of innovative
6 private market conduct that you would hope that
7 deregulation would bring about. And the private actors,
8 the wholesale market operators, brought that idea to
9 FERC as early as 1999.

10 JUSTICE SCALIA: One of the briefs, by the
11 way, says that you had no authority to deregulate it.
12 You know, we had a case involving the Federal
13 Communications Commission which wanted to dispense the
14 filing of tariffs on the part of everybody, I think,
15 except AT&T. And we held that the statute requires the
16 agency to regulate rates and required filed rates.
17 Isn't that a problem here too?

18 GENERAL VERRILLI: So I'm very familiar with
19 that case, Your Honor.

20 JUSTICE SCALIA: Yes, I'm sure you are.

21 GENERAL VERRILLI: And this case is
22 completely different. And in -- in fact, I think, you
23 know, when --

24 JUSTICE SCALIA: I mean, I like deregulated
25 markets. But the -- the problem is, do you have the

1 authority to do it?

2 GENERAL VERRILLI: Sure. I think that
3 the -- that bridge was crossed in New York v. FERC. It
4 seems to me in New York v. FERC held that that -- that
5 that deregulation, that deregulatory impulse was within
6 the authority of FERC, and that there's nothing in the
7 statutory text that precludes it. And I do think that's
8 a key point here, that what we're talking about here at
9 the end of the day is FERC's authority, which this --
10 which comes down to what the statute says.

11 And what the statute says, in Section
12 824(e), is that FERC has authority over practices that
13 affect rates in -- wholesale rates. And there's just no
14 doubt given that all of the practices FERC is regulating
15 occur in the wholesale auction. They're all embedded in
16 the wholesale auction.

17 CHIEF JUSTICE ROBERTS: If we're -- if
18 we're -- obviously, that's true. But it's just as
19 obvious, it seems to me, that you have to have some sort
20 of limiting principle, otherwise FERC can do whatever it
21 wants. So what is the limiting principle that you would
22 suggest to us?

23 GENERAL VERRILLI: I think -- I think the
24 limiting principle has worked quite well in D.C. Circuit
25 for years now is that the effects have to be direct.

1 And it's a limiting principle akin to the kind of
2 limiting principle -- common sense limiting principle
3 that the Court has used in the ERISA preemption
4 contracts with respect to relating to.

5 And with respect to direct effects, what I
6 would say is when you -- what you're talking about is
7 regulation of conduct that occurs in the auction itself,
8 participation in the auction, the rates that are
9 charge -- that are -- the -- the bids, the nature of
10 bids that can be accepted at the auction, the use of
11 those bids to balance wholesale supply and demand,
12 payment of the bidders at a rate that FERC prescribes,
13 and recruitment of that payment in the wholesale market,
14 all in the wholesale market that you've got as direct an
15 effect as you can have.

16 And we're quite comfortable with the Court
17 drawing a line that would exclude the kinds of
18 examples -- the hypotheticals that the D.C. Circuit came
19 up regulating steel, regulating -- regulating inputs
20 into electric generation. We don't think FERC's
21 authority goes anywhere near that far.

22 It -- but when you're talking about conduct
23 that occurs in the wholesale auction in the wholesale
24 market, it's just at the core of the practices affecting
25 jurisdiction that the statute --

1 JUSTICE SCALIA: That isn't the -- that
2 isn't the central conduct here. The central conduct is
3 the refusal to buy power during peak hours. That occurs
4 in the retail market. So why is that a direct effect?
5 What -- what you're -- what you're telling people is, if
6 you agree not to buy power at retail during certain
7 hours, we're going to pay you. I -- that seems to me an
8 indirect effect, not a direct effect.

9 GENERAL VERRILLI: No, the -- what the
10 conduct -- that -- that's -- that is -- it is an
11 indirect effect of the conduct that FERC regulates by
12 market participants, the wholesale market operators and
13 the -- and the participants in the wholesale auction.
14 But that's an effect. The conduct that FERC regulates
15 all occurs in that auction. It creates that incentive,
16 yes it does. But all of the conduct is in that auction.
17 It's clearly within the text of 824(e)(a). And there is
18 no text that I am personally --

19 JUSTICE SOTOMAYOR: General, I believe that
20 there is -- I understood the retailers are not telling
21 the -- the selling generators, I'm not going to use it.
22 It is the people buying from the wholesalers, which are
23 a different entity from the retailers, who are doing it.

24 GENERAL VERRILLI: That -- that -- that's
25 correct, Justice Sotomayor. And if I -- I would like to

1 make one point and then reserve the balance of my time,
2 if I could.

3 And the one point is this: There is no
4 statutory text that unambiguously denies FERC this
5 authority that it's exercising here over this wholesale
6 conduct. And given that, Chevron requires that the
7 Court uphold FERC's authority here.

8 Thank you.

9 CHIEF JUSTICE ROBERTS: Thank you, General.

10 Mr. Phillips.

11 ORAL ARGUMENT OF CARTER G. PHILLIPS

12 ON BEHALF OF THE PRIVATE PETITIONERS

13 MR. PHILLIPS: Thank you, Mr. Chief Justice,
14 and may it please the Court:

15 Justice Kennedy, I think I'd like to start
16 with the first question you asked, which is what -- what
17 do we learn essentially from Economics 101. And -- but
18 I think the way that you have to think about it is in
19 terms of the actual market that operates in this
20 particular case, which is a wholesale market.

21 It's not a market that covers the entire
22 United States. It covers less than half the States.
23 But it is an important market that was created in order
24 to create a basis for competition.

25 And up to this point, up prior to the demand

1 response initiative that was not adopted by FERC, but
2 was, in fact, pushed by my clients and those we
3 represent in private business, what we were trying to do
4 was to create a demand-side component to that wholesale
5 market. Because trying to regulate exclusively or
6 trying to -- to deal exclusively with the supply side
7 wouldn't work, or it's not as effective as it could be,
8 or certainly wouldn't necessarily guarantee you just and
9 reasonable rates.

10 And so tariffs were filed in order to
11 provide a basis for putting in the demand side. And the
12 reason why this is a direct effect on the -- on the
13 wholesale rates is because it's an absolute one-to-one
14 relationship.

15 If I put in a unit of -- of or reduce a unit
16 of demand, I don't need as much supply, and that affects
17 the price directly. And that's the direct relationship
18 that derives from the economic principles.

19 And -- and to my mind, the entirety of -- of
20 the Federal Power Act, in 201, 204, 205, asks you in the
21 first instance to look at the wholesale market that
22 exists.

23 And then once you do that, then is this --
24 you know, it's not: Does it affect the retail rate?
25 Clearly it will. The question is: Did what FERC do

1 here in the order directly affect the wholesale rate?

2 And on that score, it seems to me there's no question.

3 Then the issue becomes what --

4 JUSTICE SCALIA: Excuse me. I think moving
5 directly to control retail prices, subsidizing certain
6 retail purchases, that also would directly affect the
7 wholesale rate. And -- and does that mean FERC is
8 authorized to do that?

9 MR. PHILLIPS: I don't know that it would
10 directly affect the wholesale rate in nearly as
11 exquisite a fashion as the regulation in this case,
12 because again, you're talking about the exact same
13 transactions going on in affecting supply and demand.
14 Nothing can affect the wholesale rates that way.

15 If I make an effort to manipulate the retail
16 rates, maybe eventually it will affect the wholesale
17 rates, but it will do it in ways that are very indirect
18 as we explained in our reply brief. It may go up; they
19 may go down. It's impossible to know.

20 There's no way to doubt that if I reduce
21 supply, that that will in -- or if I -- yeah. If I
22 reduce supply, that will cause the -- the rates, the
23 wholesale rates to drop as a natural consequence.

24 JUSTICE KENNEDY: I don't mean to jumped
25 forward too -- too quickly to, really, the second

1 question, did FERC comply with its obligation to explain
2 the -- the reason for its change, but it -- it does seem
3 to me that -- that they come close together.

4 FERC's argument is essentially circular.
5 It -- it says, well, the market forces will -- will work
6 this out, but we define the market. That seems to me
7 circular.

8 MR. PHILLIPS: Well, I mean -- I don't know
9 that we define the market. We've allowed the market to
10 be created.

11 JUSTICE KENNEDY: I mean, there are two
12 parts to this argument: One is jurisdiction; the other
13 is whether --

14 MR. PHILLIPS: Right. No, I understand
15 that. But the question is what price will allow this --
16 will -- will promote this market, to create incentives
17 to allow you to have enough on the supply side -- on the
18 demand side, I'm sorry -- in order to make this
19 meaningful?

20 And what the FERC said was, when we had
21 experience with one of the regional transmission
22 operations, what happened when they reduced the price?
23 The amount of the demand response dropped precipitously.

24 And as a consequence of that, based on that
25 experience, we now have enough evidence by which to say,

1 wait a second, we need to go back and raise the price in
2 order to bring in more of the demand response, in order
3 to ensure that there is a reasonable balance between the
4 supply and the -- and the demand. But all of that's in
5 the wholesale market.

6 This -- this doesn't come close to violating
7 the principle of Louisiana Power where this Court said,
8 what is the retail authority that is preserved to the
9 State? And that's to set the rates for retail sales.

10 The State --

11 CHIEF JUSTICE ROBERTS: The problem is --

12 MR. PHILLIPS: I'm sorry, Your Honor.

13 CHIEF JUSTICE ROBERTS: -- that what FERC is
14 doing basically leaves the States with the pure
15 formality of setting the rate that is going to be
16 directly affected by what FERC is doing.

17 In my hypothetical, if you remember, I mean,
18 they get to say how much the hamburger costs once you
19 get in the store, but FERC can respond to it directly by
20 setting the price to encourage you not to enter the
21 store.

22 If I -- if -- if \$5 -- we'll give you \$5 not
23 to enter, and a burger is \$3, if it's -- the State gets
24 to say, no, no, we want it to be \$2, and then FERC just
25 says, all right, we'll give you \$6 not to enter.

1 MR. PHILLIPS: Right. But that all assumes
2 that what -- what FERC is trying to do here is to, in
3 fact, directly regulate the rates. That's not -- that
4 was never the intention behind this exercise.

5 The intention here is to try to
6 manipulate -- not to manipulate, but to control --

7 JUSTICE KENNEDY: It may not be --

8 MR. PHILLIPS: -- the wholesale rates in a
9 way that would not --

10 JUSTICE KENNEDY: It may not be the
11 intention, but it's the mechanism.

12 MR. PHILLIPS: Right. But -- but the
13 statute --

14 JUSTICE KENNEDY: So you say, oh, well, we
15 didn't mean this, but we're doing it.

16 MR. PHILLIPS: Well, I -- you know, ONEOK
17 sort of says what you intend, what you -- what your
18 intent is and what's directed at actually controls in
19 some ways this area, but we're talking about a situation
20 of concurrent jurisdiction between the State and the
21 Federal government in this particular context.

22 And so the fact that there are going to be
23 effects on the retail rates doesn't deprive FERC, which
24 ultimately is the supreme authority here, as long as it
25 operates within the sphere of adopting -- of dealing

1 with a practice, regulating a practice that will in fact
2 affect the wholesale rates. And that's precisely what
3 it has tried to do in this particular context.

4 And -- and, Justice Kennedy, I don't think
5 there's a problem with respect to the way the rates were
6 set, because again, if you do it in the -- in this very
7 sort of fundamental Economics 101 approach, which
8 Dr. Khan is the one who -- who was the primary proponent
9 of it, said, look, if you're -- if you're taking out
10 demand, if you're -- if you're reducing demand, that
11 affects supply directly, and therefore, you should
12 compensate them exactly the same.

13 And FERC looked at that and said, you know,
14 that makes perfect sense to us. That's an appropriate
15 way to go. That will -- you know.

16 That's not a -- that's not luring people;
17 that's just providing a basis upon which there will be
18 enough of a market in order to allow the wholesale side
19 of the -- of the grid system to operate in an efficient
20 way. Not only to reduce the wholesale prices, which is
21 important, but even more fundamentally, Your Honor, to
22 protect the reliability of the grid.

23 That was what prompted, frankly, the initial
24 effort to deal with this entire demand response issue,
25 was to figure out what are we going to do about

1 brownouts? What are we going to do about blackouts?
2 How are we going to be able to -- because we can't do it
3 if we just do it on the -- on the -- on the generation
4 side.

5 We need to reduce the demand in order to
6 ensure that in response to these kinds of crises, there
7 is an answer.

8 This is the answer. Commission has operated
9 exactly the way it ought to have under these
10 circumstances.

11 JUSTICE SCALIA: Why -- why -- why aren't
12 all the companies in agreement with you? Why are there
13 some -- some private companies on the other side?

14 MR. PHILLIPS: Well, most of the private
15 companies on the other side generate electricity and
16 would prefer not to manipulate the supply side because
17 they're -- they're -- I mean, manipulate the demand side
18 because they like to have all of the supply side going
19 to as far as you can take it.

20 JUSTICE SCALIA: But they're not all
21 generators I don't think.

22 MR. PHILLIPS: They're pretty -- I mean,
23 there's a substantial number of them. I mean, the vast
24 majority of them on the other side are -- are
25 generators, Your Honor.

1 JUSTICE SCALIA: Well, maybe your
2 colleague can -- can answer it.

3 MR. PHILLIPS: I'll let him count up his
4 amicus briefs, if he -- if he wishes.

5 And -- and the last thing I guess I would
6 say is -- is I agree with General Verrilli's point, that
7 if at -- at all -- if all else fails, this is clearly a
8 question -- these are both questions that are -- in
9 which the Commission deserves deference. It deserves
10 deference on the question of the scope of its
11 jurisdiction, and it assuredly deserves deference,
12 Justice Kennedy, in deciding as between locational
13 marginal price and locational marginal price minus G or
14 minus G plus A, or however you would go about that.

15 If there's any issue upon which this Court
16 ought to say the Commission gets a -- gets more than a
17 thumb on the scale, it would be that issue.

18 If there are no further questions, Your
19 Honor. Thank you.

20 CHIEF JUSTICE ROBERTS: Thank you,
21 Mr. Phillips.

22 Mr. Clement.

23 ORAL ARGUMENT OF PAUL D. CLEMENT

24 ON BEHALF OF THE RESPONDENTS

25 MR. CLEMENT: Mr. Chief Justice, and may it

1 please the Court:

2 I don't usually start in this Court by
3 telling you who I represent, but I think I better do it
4 here, which is I represent not just EPSA, which is a
5 group of power generators, but a number of other --
6 other organizations.

7 So the vast majority of the people that I
8 represent are load-serving entities who are not
9 exclusively on the supply side. They're actually the
10 regulated public utilities that actually could provide
11 demand response in a wholesale, meaningful level by
12 working, as they have since long before FERC got in this
13 business, to work with retail customers and their State
14 relaters to provide for reduced retail demand at peak
15 time. So that's who I represent.

16 Now what I'd like to start, beyond telling
17 you who I represent, is with the notion of what FERC was
18 trying to do here, which was to reduce retail demand by
19 providing payments to retail customers on an otherwise
20 wholesale market in an effort to change the effective
21 price for retail sales.

22 Now, that sure sounds like something that
23 belongs to the States. So the answer you hear --

24 JUSTICE SOTOMAYOR: Where is that --

25 MR. CLEMENT: -- from the general --

1 JUSTICE SOTOMAYOR: Where is that in --
2 written anywhere that that was their goal? That's how
3 you've characterized that goal. But what I've heard
4 them say is, we're trying to lower the price of
5 wholesale to a more just amount. That's what's in
6 anything I've seen written. You've recharacterized it.

7 MR. CLEMENT: I don't think it's just a
8 characterization battle ultimately. But even if you
9 want to stipulate that they are trying to reduce retail
10 demand for the best of wholesale reasons, it's still --

11 JUSTICE SOTOMAYOR: But in the retail
12 market.

13 MR. CLEMENT: What? I'm sorry?

14 JUSTICE SOTOMAYOR: They're -- they're
15 generators selling to intermediaries. The
16 intermediaries are the ones who are in the market with
17 the retailers.

18 MR. CLEMENT: That's not correct, Justice
19 Sotomayor. It's crystal clear, and I don't think the
20 Solicitor General will contradict me in his rebuttal,
21 that what FERC does uniquely in this context is invite
22 retail customers, directly large retail customers --

23 JUSTICE BREYER: That's true. That is true.
24 That --

25 MR. CLEMENT: -- directly on the wholesale

1 exchange.

2 JUSTICE BREYER: That is true. What you say
3 is true. Every reduction in demand for a unit of retail
4 electricity is ipso facto a demand for a reduction of a
5 unit of wholesale electricity, and vice versa. So it's
6 hardly surprising that anything they do in the wholesale
7 market that adds to demand will add to demand in retail,
8 and vice versa.

9 But I thought that their motivation here is
10 the following: On the 4th of August at 4:00 p.m.,
11 people turn on electricity for air-conditioning. That's
12 the peak hour. The industry, leaving reserves out of
13 this as a fixed matter, has to supply that. So if there
14 are not enough generators at 4:00 p.m. on August the
15 4th, they have to build one.

16 And to build an additional generator -- I
17 don't know what gas costs now, but let's imagine it's
18 \$500,000, and that will be passed on in the wholesale
19 price, and then probably, though the States are free to
20 do what they want, in the retail price.

21 So FERC thinks I have another way of doing
22 this. For only \$400,000, I can be sure that on the 4th
23 of August at 4:00 p.m., the demand is not great enough
24 to spend the 500, and so we group the people who will
25 promise to fulfill their air-conditioning at other

1 times.

2 That way, the price of wholesale electricity
3 falls. And, therefore, we satisfy all demand at a lower
4 price. We are interested in wholesale. We are
5 interested in how to satisfy peak wholesale demand. And
6 we have worked out a way to do it cheaper. Of course it
7 affects retail prices, so does everything we do in
8 respect to wholesale prices. End of the matter.

9 So I accept your characterization, but I do
10 not see any law that prevents them from raising or
11 lowering wholesale price despite the fact that that
12 affects retail price.

13 MR. CLEMENT: And I certainly wouldn't be
14 here suggesting that anything that happens in the
15 wholesale market that affects retail price is somehow
16 verboten to FERC. But I am here to say that when you
17 regulate wholesale prices, essentially as Justice Scalia
18 suggested, through the retail market, that that crosses
19 a very important boundary in the Federal Power Act. And
20 with all due respect to your question, your approach to
21 this would make perfect sense if FERC were the only
22 regulator on this scene, but --

23 JUSTICE BREYER: It didn't affect -- it
24 didn't try -- what it said was, we have a group of
25 people who will put customers together, and those

1 customers will, in fact, cut demand at 4:00 p.m. on
2 August 4th. As I say, that affects retail price; so
3 does everything.

4 MR. CLEMENT: But --

5 JUSTICE BREYER: And -- and what is the
6 difference here -- and that's what you want to get at,
7 so I'm letting you do it --

8 MR. CLEMENT: I -- I --

9 JUSTICE BREYER: -- the difference here and
10 what I just said? Everything.

11 MR. CLEMENT: The difference here is that
12 the customers they're targeting are retail customers,
13 and the very fact -- and this is what I -- where I
14 really wanted to go, which is, I think the Solicitor
15 General goes a long way to conceding that this really is
16 going at retail -- the retail market and the retail
17 level of demand matters, and he will concede that we're
18 changing -- they're changing the effective price of
19 retail electricity.

20 The only -- the saving grace for them is,
21 ah, but we're limiting ourselves to the wholesale
22 market, and we're the wholesale regulator. So why
23 shouldn't we do it?

24 Here's the problem: These retail customers
25 don't belong on the wholesale market. Whether you think

1 they were lured in or you think they walked in the door,
2 it doesn't matter. They are in a market where they
3 don't belong. The fact that they are regulating in this
4 context and this context alone, retail customers
5 directly, is a profound signal that they've overstepped
6 their jurisdictional bounds.

7 And I think the way you can understand why
8 the fact that they're on the wholesale market is not a
9 complete answer is to consider the following scenario,
10 which doesn't seem all that farfetched, which is to say
11 a large retail consumer of electricity, let's call it
12 Wal-Mart, decides, you know what, I like the prices on
13 the wholesale market better, and I buy more electricity
14 than a lot of load-serving entities in small
15 jurisdictions. So I'm going to walk on to the wholesale
16 market run by an ITO or an IPO, and I'm going to buy
17 electricity for my own consumption at a better price.

18 If they did that, I don't think there is any
19 question that that would be a retail sale that could
20 only be regulated by the States. And if that actually
21 happened, then the RTOs and ISOs would have to make a
22 choice. They would either open themselves up to
23 regulation simultaneously by FERC and the States for
24 that retail transaction, or they would do what I think
25 they probably would do, which is, one regulator is

1 plenty.

2 We're just going to say that Wal-Mart can't
3 come on to our market and buy retail gas directly from a
4 generator. And that's the world we live in. Wal-Mart
5 can't walk on that market and buy --

6 JUSTICE SOTOMAYOR: So what's the -- what's
7 the horror here of concurrent jurisdiction? You seem to
8 posit that this is horrible, but if, in fact, it's
9 lowering prices, Wal-Mart sees it as a lowering of
10 prices, I -- hard to think of why States would say no,
11 but some of them have. But I'm not sure what the
12 problem is with concurrent jurisdiction.

13 MR. CLEMENT: Well, Your Honor, I'm not
14 sure, ultimately, that my burden is to show that this is
15 horrible as opposed to ultravirus. But let me try to
16 explain to you why concurrent jurisdiction is an anomaly
17 in the context of the Federal Power Act. I mean, this
18 Court, on numerous occasions, has said that although
19 you -- sometimes it's hard to divide the lines. Once
20 you do, generally the Federal government operates in its
21 exclusive sphere of the wholesale market, and the States
22 regulate in -- exclusively in the retail market.

23 JUSTICE SOTOMAYOR: But they all -- each of
24 them affect each other.

25 MR. CLEMENT: But here's the problem --

1 yeah, normally they stay away from each other and each
2 other's customers.

3 Another thing that is a complete anomaly
4 that FERC has created here that, as far as I'm aware,
5 exists nowhere else in the energy world, is you actually
6 have the Federal government and the Federal regulators
7 and the State regulators bidding against each other for
8 the same customers to reduce their same retail demand.

9 And the other side has made a very big deal
10 that none of the States raised a jurisdictional
11 objection before FERC itself. But there were a number
12 of States, Ohio, Illinois, and all of the States that
13 are participants in the MISO, one of the ISOs. And what
14 they told FERC is, by all means, do not set the
15 compensation level at LMP, because that's too high. And
16 by setting it so high, what you are going to do is
17 you're going to crowd out our own efforts at dealing
18 with demand response. Because we love demand response.
19 We want demand response. But we don't want to pay twice
20 as much as the market really should pay for demand
21 response. And if you're out there offering our same
22 retail customers the ability to get demand response paid
23 at huge LMP levels, then we're going to be crowded out.
24 Now, the only response that FERC can offer
25 to that is, well, then just opt-out, come on, you know.

1 First of all, that's the third anomaly here,
2 because there's no other area of regulatory authority
3 where FERC allows States to opt-out. And if you think
4 about what they're opting out and compare it to their
5 legal theory, it doesn't work. I mean, since when is
6 FERC all of a sudden enthusiastic about State
7 experimentations with practices that directly affect
8 wholesale rates?

9 In every other context where they actually
10 have jurisdiction, wholesale rates, transmission, not
11 only would they not allow State opt-outs, but they would
12 say it's going to lead to discrimination in a way that
13 would be unjust and unreasonable.

14 So the opt-out option here, though, doesn't
15 work for another reason, which is it's worse for the
16 States that most want to provide for demand response.
17 Because what they're being told is, all right, you have
18 a subset of your customers who are actually interested
19 in demand response. And if you want to opt-out, what
20 you have to tell your customers who are interested in
21 demand response is we're actually going to pass a
22 regulation that restricts you, and you can't go into the
23 Federal market and get a better rate --

24 JUSTICE BREYER: I guess if you're --

25 MR. CLEMENT: -- you're going to have to

1 take a lousier rate.

2 JUSTICE BREYER: If you're right, then I
3 guess the FERC could not direct the grid approvals in a
4 way that would, in fact, prevent certain retail
5 customers from buying electricity at certain times. I
6 guess that FERC could not, in fact, allow large
7 consumers of electricity to buy at wholesale, because
8 that would take the retail customers away from the
9 jurisdiction of the State.

10 I guess that FERC could not, in fact, insist
11 upon a marginal capacity being generated from natural
12 gas instead of from other things, because that will
13 affect the price of natural gas, will affect the
14 wholesale rate, thereby raising the retail rate, thereby
15 stealing customers away from, let's say, Ohio, where it
16 goes up, and forcing them to go to Texas.

17 I mean, I have not been surprised that I
18 have found no case in which FERC ever tried to do
19 anything roughly comparable or even by the roughest
20 analogy that would say that they cannot do this for the
21 reason you suggest.

22 MR. CLEMENT: Well, Your Honor, there is a
23 lot in that question, but let me just respond --

24 JUSTICE KAGAN: No, all there were meant to
25 be was three examples, and I don't know how good they

1 are, but they come to mind.

2 MR. CLEMENT: Well, with all due respect, a
3 couple of them aren't that great because --

4 (Laughter.)

5 MR. CLEMENT: -- because you seem to suggest
6 that if you can't do this, well, then FERC can't
7 essentially tell generation resources that we don't want
8 any more coal generation; we only want natural gas.
9 And, of course, they can't do that because the Federal
10 Power Act reserved the plenary authority of regeneration
11 to the States.

12 You also suggested if they can't do that,
13 then they can't allow Wal-Mart to helpfully walk into
14 the wholesale market and buy at retail.

15 JUSTICE BREYER: I was grasping your point,
16 which I hadn't grasped previously. And your point seems
17 to be that the problem here is the way they are reducing
18 the demand, and therefore, the cost of wholesale
19 electricity, is by taking a -- groups of people and
20 preventing them from buying electricity at all at
21 certain times, which, of course, affects their buying
22 retail.

23 Isn't that basically your point? And if it
24 is, I was trying to think with that argument. That's --
25 that's why I said that you can skip the whole thing if

1 you want.

2 MR. CLEMENT: Well, here -- here's a way
3 of -- of trying to harmonize that, which is I think that
4 the line that the Federal Power Act divides -- draws is
5 between retail sales and wholesale sales. And I believe
6 that this is impermissibly on the retail side of the
7 line.

8 I think my friends on the other side
9 ultimately think that the difference isn't between
10 retail and wholesale but is between sales and nonsales,
11 because they appear to concede my Wal-Mart example in
12 the retail world. Which is to say, on page 39 of the
13 SG's brief, I think they pretty much concede that
14 Wal-Mart cannot walk on to a wholesale market and
15 purchase gas at retail without coming into the scope of
16 the State regulators.

17 I think they also concede that, if the
18 government's interest here was not to suppress retail
19 demand but to increase it, they thought, you know, if we
20 could just sort of boost retail demand a little bit,
21 we'd get a whole bunch of these new green resources
22 online and it would actually make, you know, everything
23 better.

24 So we want to increase retail demand. So
25 here's what we're going to do: We're going to have

1 either directly or through the wholesale operators --
2 we're going to pay a bonus to people who increase their
3 retail purchases.

4 That, I believe, my friends on the other
5 side say, well, no FERC couldn't do that because that
6 would affect a fully-consummated sale.

7 So their position seems to be although we
8 can pay -- we can't pay incentive payments to increase
9 retail demand, we can pay incentive payments to reduce
10 retail demand.

11 Two observations about that: One is, why in
12 the world would that make sense? I mean, why in the
13 world would -- would Congress have divided the authority
14 here in a way that allows the Federal government to
15 suppress retail demand but not increase retail demand?

16 The second thing that I want to say about
17 that anomaly, though, is the line between sales and
18 nonsales can't be the right line because it -- if it is,
19 then not only can they do what Justice Scalia suggested,
20 which is have FERC pay a direct bounty not to purchase.
21 And I was actually quite surprised by the Solicitor
22 General's answer to that. And he -- and he didn't fully
23 complete the answer. He said that would be a harder
24 case, but he didn't ultimately say how that would be
25 answered.

1 I think he has to say that, if FERC sort of
2 cut out the wholesale operators and just said, we got a
3 new appropriation, and every retail customer that
4 reduces their retail consumption gets a \$200 check from
5 FERC, that has to be consistent with their position that
6 FERC can do it because it doesn't interfere with a fully
7 consummated deal.

8 But we're still -- if they're right, then
9 what FERC can do tomorrow is solve this problem much
10 more directly. They can say, retail customers, you
11 cannot buy at peak times. You simply can't. We're not
12 going to allow it. Because that's going to reduce
13 the -- the -- the wholesale demand. It's going to avoid
14 brownouts. It's going to take all the pressure off our
15 grid. So that's it. No more purchases on August 4th.

16 JUSTICE SCALIA: And they're not regulating
17 the rate of sales.

18 MR. CLEMENT: They're not regulating the
19 rate of sales. So, you know, never mind. Or -- or --
20 or the rate of sales is -- is either zero or infinity
21 because you can't do it.

22 But any way you think about it, that has to
23 be the implication of their theory that there is a
24 categorical difference between --

25 JUSTICE BREYER: They have to be reasonable

1 in what they do under Chevron. It's a broadly-phrased
2 statute. What they have to do is reasonable.

3 And so really the question is: Is what
4 they're doing here unreasonable?

5 MR. CLEMENT: Well --

6 JUSTICE BREYER: And -- and I -- and we're
7 not electricity regulators; they are. It's pretty tough
8 and technical.

9 And -- and so that's why I -- I've been
10 trying to figure out just what it is about this thing
11 that, in your view, makes it unreasonable.

12 MR. CLEMENT: And what is unreasonable is
13 that, before you get to a Chevron question, certainly
14 before you get to an arbitrary and capricious question,
15 you have to have jurisdiction for FERC to do this.

16 And the basic division of authority in
17 201(b) of the Federal Power Act is that the Federal
18 government gets sales for resales and the States get all
19 other sales.

20 And I think it's important to recognize that
21 you really have to wrestle upfront with the 201(b)
22 question because the other side loves to talk about 205
23 and 206 in the practices affecting language. But the
24 problem with that is that 201(b) specifically says that
25 the provisions of this subchapter, which include 205 and

1 206, shall apply to sales for wholesales and shall not
2 apply to all other sales.

3 So you don't get to 205 and 206 if what is
4 being regulated front and center is a retail sale of
5 electricity.

6 JUSTICE KAGAN: Mr. Clement --

7 JUSTICE KENNEDY: And at some point of -- I
8 want you just to assume that there is jurisdiction, but
9 to discuss your point that section -- that Rule 745,
10 particularly, was arbitrary and capricious, I assume,
11 because adequate reasons or no reasons were given. Or
12 maybe there's some other point. But at some point
13 before your time runs out.

14 MR. CLEMENT: I -- I -- I will definitely do
15 that, Your Honor. I don't know if you had a question
16 that goes to jurisdiction that you want to talk -- I
17 mean --

18 JUSTICE KAGAN: Do you mind, Justice
19 Kennedy, if I --

20 JUSTICE KENNEDY: No, of course.

21 JUSTICE KAGAN: Yes?

22 I mean, I take it that the -- the
23 implications of your argument is that FERC can't do
24 anything with respect to demand response; is that right?

25 MR. CLEMENT: No, that's not right. My

1 position is that FERC can't do anything with demand
2 response with retail customers. They can do demand
3 response, true wholesale demand response, which they
4 were actually doing before they went down this route and
5 around, you know, the -- the two -- early 2000s.

6 And the way that wholesale demand response
7 works is the way you sort of naturally think it would
8 work, which is through a participant in the wholesale
9 market, namely through the load-serving entities who are
10 mostly my clients.

11 Because the way you can sort of do this is
12 you work cooperatively with the States and the LSEs, and
13 you encourage them, as Congress suggested in 1252(e) of
14 the -- of the National Policy Act or the Energy Policy
15 Act. You encourage them to do all sorts of things to
16 reduce their demand, and then there's just less demand
17 bid in to the auction in the first place. And so supply
18 meets demand at a much lower level.

19 Just for completeness sake, you can also
20 have wholesale participants participate in a
21 demand/response program in the forward-capacity markets,
22 where, again, it would be the LSEs. And what they would
23 do is say, we're going to -- we're going to -- three
24 years hence, we're going to reduce our compensation --
25 or our -- our consumption by this level, and we're going

1 to do it on the local level.

2 And just to further complete that thought,
3 you know, it's -- it's nice to talk that FERC has been
4 doing this since 2000, but the States have been doing
5 this long before that, at least since the 1980s.

6 And there is a brief for other respondents
7 that I don't represent, the Midwest load-serving
8 entities. And it's worth a -- it's a short brief, but
9 it's worth a quick read because what they say is, look,
10 we've been doing this at the State level since 1984.
11 We're a local utility. We work with our local
12 regulator. Because we have plenary authority over the
13 retail market, we can deal with demand response in all
14 sorts of ways that FERC could never imagine. And we can
15 do things like basically go in and get a local customer
16 to agree with us to change the way -- their thermostat.
17 We can go in, send somebody in, put different hardware
18 in there, and then, based on a reduction in their retail
19 rates, we can get them to agree that basically, on a hot
20 day in the summer, we get to take over your thermostat.
21 And we directly impose demand response through that.

22 And that's the kind of thing that States
23 have been doing since the '80s. And that's the kind of
24 things that are going to be crowded out by this
25 one-size-fits-all rule with the high LMP

1 compensation recipe.

2 JUSTICE KAGAN: And so this sort of
3 practice, though -- so I'll just narrow the question --
4 where it's retail actors who are bidding into a
5 wholesale market.

6 MR. CLEMENT: Right.

7 JUSTICE KAGAN: I take it that there, there
8 would be a regulatory gap. In other words, FERC can't
9 do anything nor can the States do anything.

10 MR. CLEMENT: I -- there is not a -- a
11 regulatory gap. I don't think FERC can do anything.
12 And I would answer it by reference to my Wal-Mart hypo
13 going in to buy.

14 If Wal-Mart went in to buy -- so if a retail
15 customer on the buy side sort of walks into a wholesale
16 market -- it's not that lightning strikes and they can't
17 do it. It's that it's a retail transaction. So if
18 anybody can regulate it, it's the States.

19 So there's not a regulatory gap. In theory,
20 a State could regulate the transaction even though it
21 takes place on an otherwise wholesale market.

22 I think as a practical matter -- I don't
23 want to -- as a practical matter, I don't think the ISOs
24 and the RTOs want to be regulated by both FERC and the
25 States. So I think what they would do is, ah, if the

1 price of having a retail customer on our otherwise
2 wholesale market is we get State regulation on top of
3 Federal relation, then we're going to bar the door to
4 the retail customer.

5 CHIEF JUSTICE ROBERTS: Maybe you can turn
6 to the question Justice Kennedy asked you to address.

7 MR. CLEMENT: I -- I -- I would be delighted
8 to.

9 If I could say one last thing about
10 jurisdiction, which is simply I -- I do think, though,
11 that the premise of the other side's argument is that
12 the sky will fall if you don't have this precise type of
13 retail customer on wholesale market demand response.
14 And there, I think, it's worth taking a look at the
15 Southern company's brief, because they operate in a part
16 of the country that doesn't have an RTO or an ISO.

17 JUSTICE KAGAN: It -- it is an odd result,
18 given this Energy Policy Act which made it so clear that
19 Congress liked demand response that it wanted FERC to
20 lower barriers to demand response, to then say, well,
21 FERC has no jurisdiction to do exactly what the policy
22 that Congress articulated is.

23 MR. CLEMENT: But the problem with that way
24 of looking it, Justice Kagan, with all due respect, is I
25 think it looks only at 1252(f), which is the one

1 reference to what FERC's supposed to do, and it ignores
2 1252(e) where Congress recognized that the States are
3 the primary actors here.

4 And the point I was making about the
5 Southern company brief is operating in an area without
6 ISOs, without RTOs, so without FERC, they actually have
7 a greater level of demand response than other parts of
8 the country that have the Federal rule.

9 So to bring us to the arbitrary and
10 capriciousness question, I think, Justice Kennedy, the
11 way I think about it is that we have both procedural
12 objections and substantive objections.

13 The procedural objections are essentially
14 that there are all sorts of objections to using LMP as
15 the price to provide compensation.

16 That wasn't just my clients. That was also
17 the States that I alluded to who were worried that this
18 high level of compensation would crowd out their
19 efforts.

20 It was a particularly poignant comment from
21 the -- the -- some of the ITOs and RTOs who design
22 these -- run these wholesale markets.

23 And the ones that I thought were most
24 persuasive in some respects was the operators of the
25 MISO, the midwestern one, because at FERC's direction,

1 they basically spent two years trying to come up with --
2 get all the stakeholders in a room and come up with a
3 formulation -- a compensation formula that worked. And
4 what they came up with was essentially LMP minus G.

5 And after having spent two years with all
6 the stakeholders coming up with LMP minus G, they were
7 then told by the Federal government at a late breaking
8 hour that there was a one-size-fits-all solution, and it
9 was LMP.

10 JUSTICE SOTOMAYOR: Well, wait a minute.
11 That's the classic choice that we give agencies. They
12 had expert testimony, Dr. Khan, who was undisputed to be
13 a leading expert in this field, say the opposite. I
14 mean, how do we choose to go into the weeds of something
15 as technical as that --

16 MR. CLEMENT: Well, I think --

17 JUSTICE SOTOMAYOR: -- when that's been
18 entrusted to the agency?

19 MR. CLEMENT: Surely it has. But the reason
20 I started with the procedural way of coming at this is
21 the D.C. Circuit has lots of arbitrary and capricious
22 cases, and they are quite comfortable in saying that, in
23 circumstances like this, you didn't respond adequately
24 to the comments that were put before you.

25 JUSTICE SOTOMAYOR: Would you tell me which

1 one? I mean, I looked through everything that the
2 dissenter said, and there is at least one or two or
3 three paragraphs in the FEC's report on this that
4 directly explains why they chose a different route.

5 MR. CLEMENT: Well, there is certainly --

6 JUSTICE SOTOMAYOR: The -- the -- the court
7 below didn't give us one comment by the dissenter that
8 wasn't addressed by something said in the report.

9 MR. CLEMENT: Well, I can give you an
10 example, Justice Sotomayor, if it will help, which is
11 that Chairman Mueller in his dissent -- Commissioner
12 Mueller in his dissent actually used a hypothetical that
13 is very similar to the hypothetical discussed in our
14 brief and the SG's brief about a factory and how if --
15 if you have full LMP, a factory will essentially reduce
16 its production at time periods where it's economically
17 inefficient for them to do so.

18 JUSTICE SOTOMAYOR: And they -- and they
19 recognized that, and what did they say?

20 MR. CLEMENT: They -- they had no --

21 JUSTICE SOTOMAYOR: Only when it's
22 economically feasible will we pay this price.

23 MR. CLEMENT: Well, the way I read the --
24 the way I read the record, Your Honor, is that there was
25 no response to that hypothetical, just as there was no

1 response in the SG's --

2 JUSTICE SCALIA: The response was where it
3 doesn't work, we won't use it, which I didn't find a
4 very satisfactory response. Isn't that essentially what
5 they said?

6 MR. CLEMENT: I'm not even sure they -- they
7 said that much, but I don't think they really grappled
8 with it.

9 And to whatever extent they --

10 JUSTICE BREYER: I thought that the response
11 was what Justice Sotomayor, and the way -- I wouldn't
12 characterize it that way, but it's called the "net
13 benefits test." And the net benefits test means this is
14 not a one size fits all.

15 And then in the order, at paragraph 17, 18,
16 page 67, they go through a bunch of methodologies, and
17 they -- I mean, they say, we're picking this one.

18 And the reason that they pick this one, I
19 guess, is they think it's -- if you try a G thing, that
20 also is a problem administratively.

21 Okay. Now, I'll just read those. Is there
22 anything else you're going to tell me that -- I'll read
23 them and see what they say, right?

24 MR. CLEMENT: Sure. Well, I would -- I
25 would -- I would encourage you to look at the FTC

1 comments, the Joint Appendix page 281, the comments of
2 the States.

3 I mean, I would think that when you have
4 another coordinate part of the federal government come
5 in and say, you are picking the wrong compensation level
6 and it will be affirmatively inefficient and will crowd
7 out other uses for demand response, that you'd at least
8 owe them something more of an explanation than grouping
9 them in a footnote with every other commentator you got
10 and say, we're not persuaded by that.

11 There is, though, I think -- and I would --
12 actually, you know, I -- I didn't think I would come up
13 here talking about net benefits test, but I actually
14 would --

15 JUSTICE BREYER: I'll read -- Cicchetti that
16 writes about that in the brief, doesn't he?

17 MR. CLEMENT: Yes. Yes.

18 JUSTICE BREYER: And so I think that's the
19 best brief to read on that.

20 MR. CLEMENT: Yes.

21 JUSTICE BREYER: Right? Okay.

22 MR. CLEMENT: And -- and -- and what I would
23 say beyond that about the net benefits test is here's
24 another way in which the -- the compensation formula is
25 what I would call substantively arbitrary and

1 capricious.

2 The whole formula is built on the idea that
3 there is an -- an equivalence between less demand and
4 more actual supply of energy. But of course, when you
5 get to the nitty-gritty of it, it turns out that's not
6 true, because the great thing about actual supply of
7 energy is that other wholesale -- real wholesale
8 customers buy it, and then the market clears naturally.

9 But when you start getting a third-party in
10 there, a retail customer who really doesn't belong there
11 and start saying, we're going to pay you money, but that
12 money doesn't actually result in load that -- a
13 load-serving entity pays for, that creates a deficit in
14 the wholesale account.

15 JUSTICE KENNEDY: Is one way to think about
16 that is that the -- FERC's argument is circular. It
17 says, well, the market will take care of this, but we
18 define the market.

19 MR. CLEMENT: Yes. And yet, it's -- the
20 market really can't take care of it because the market's
21 designed to simply get a bunch of wholesale sellers and
22 a bunch of wholesale buyers together, and the price of
23 the sales and the price of the purchases equal each
24 other out, and everybody goes home happy.

25 But when you invite retail customers on and

1 say, guess what, we're going to pay you not to buy, that
2 creates a market imbalance.

3 The FERC euphemistically refers to this is
4 the billing unit effect. And then they have to solve
5 that by making adjustments to the market clearing price.
6 And then to make sure they don't go too far down, they
7 apply the net benefits test, which is not only
8 mind-bogglingly complex, but FERC itself recognizes that
9 it's imperfect.

10 The last thing I want to say, though, about
11 sort of the substantive unreasonableness about this is
12 there is a more fundamental problem here, and it's -- I
13 think the economist's brief on our side gets at this
14 very well, which is at the end of the day, if FERC gets
15 to do this on the wholesale markets, what is being
16 purchased is not energy, actual energy that's been
17 bought and then sold. What is being sold is an option
18 to buy electricity at a subsidized retail rate.

19 And in any other market -- I mean, think of
20 a stock where I have an option to buy it at 20 and the
21 market price is 40. Lots and lots of people are going
22 to offer me 20, 19 for that option because I have a
23 valuable right to buy something at a below-market price.

24 But nobody is going to offer me 40 for the
25 option to buy at 20 just because the market price is at

1 40. But that is exactly what FERC has done by setting
2 the compensation rate at LMP.

3 And they made mincemeat out of poor
4 Dr. Kahn, because what Dr. Kahn really says is that the
5 market signal that the customer ought to get is LMP.
6 But the market signal they get is LMP if it accounts for
7 avoided costs.

8 If you take the avoided costs out of the
9 question, then you get LMP plus the retail costs.

10 And of course, another irony here is the
11 distortion is greatest in those markets where the States
12 have done exactly what FERC would like, which is adopt
13 retail price -- realtime pricing, because then the
14 retail price is LMP.

15 And so what is the compensation rate for
16 demand response providers? It's twice LMP.

17 JUSTICE BREYER: I thought -- you don't
18 have -- I mean, I thought that he -- frankly the net
19 benefits test was meant to deal with -- deal with this
20 problem.

21 I will read Kahn's testimony, I promise. I
22 will read Cicchetti, and I will read Hogan too. Okay?

23 MR. CLEMENT: Please read -- please read
24 Dr. Hogan as well, because I really do think he has the
25 better of this argument.

1 Now, you would say, generally, well, couple
2 of expert economists, just let FERC decide. But I do
3 think in this case they have strayed beyond the bounds
4 of arbitrary and capriciousness, Justice Kennedy.

5 JUSTICE KENNEDY: But I -- I take it you're
6 asking us not to make the judgment as to which was right
7 and which was wrong, but that -- but that FERC did not
8 address it by giving specific-enough reasons.

9 MR. CLEMENT: Yes. That -- that is the
10 principal reason. But I -- but I don't want to suggest
11 that it's just purely procedural because I don't think
12 these are things they can fix.

13 And of course, we hope that you don't even
14 get to that question because you find they don't have
15 jurisdiction.

16 Thank you.

17 CHIEF JUSTICE ROBERTS: Thank you, counsel.
18 Five minutes, General.

19 REBUTTAL ARGUMENT OF GEN. DONALD B. VERRILLI, JR.
20 ON BEHALF OF THE FEDERAL PETITIONER

21 GENERAL VERRILLI: Thank you, Mr. Chief
22 Justice:

23 Starting on the jurisdictional issue with
24 text, my friend pointed to Section 824(b), which you can
25 find at 1(a) of the appendix to our brief.

1 What it says is not that FERC shall have
2 jurisdiction over sales of electricity at wholesale. It
3 says the provisions of this subchapter shall apply to
4 sales of electricity at wholesale.

5 One of those provisions is 824(e) (a), which
6 says FERC shall have jurisdiction over practices
7 affecting wholesale rates.

8 So we're within the plain terms of the
9 statute, and there is no statutory text that plainly
10 forecloses FERC's exercise of jurisdiction. And my
11 friend, in 30 minutes, didn't even try to identify one.

12 So in terms of applying Chevron, there's no
13 doubt that -- that FERC's interpretation has to be
14 upheld.

15 With respect to the Wal-Mart example that my
16 friend identifies, I think it shows why his argument
17 about hermetically-sealed-off retail and wholesale
18 spheres really has nothing to do with the real world.

19 In the real world today, large customers can
20 buy directly. They can do it through contract, and they
21 can also go into the wholesale market auctions and buy,
22 if their States permit it, and that does happen in the
23 real world.

24 And this is really no different because
25 demand response entities that want to come in and

1 participate can only do so if their State law allows
2 them to do so. So it's no different than what's been
3 going on in the real world for quite a long time.

4 Third, with respect to the load-serving
5 entities, the -- the utilities, my friend says, well,
6 don't worry about it; they'll do all the demand
7 response. It will work great.

8 FERC addressed that. It addressed it
9 directly. It found that load-serving entities don't
10 have sufficient incentives to engage in demand response.
11 And it's obvious why they don't, because they
12 cannibalize their own profits. The higher cost they
13 have, the higher their rate of return profits are going
14 to be generated. They will do it under commands from
15 State regulatory agencies to do it, but they'll do it
16 grudgingly. And what FERC said is you want people to
17 come in who have a real profit motive to do it, and
18 that'll incent the LSEs to get in there and try to get a
19 piece of the action rather than letting it go to
20 somebody else.

21 But FERC addressed that issue specifically.

22 Now, the idea that demand response can't
23 work, the State-level demand response, retail demand
24 response can't work where wholesale demand response is
25 operating, you know, again, the real world just

1 contradicts that. We have 24 States in which this is
2 going on. And if this were a problem, you'd expect to
3 see in this administrative proceeding some evidence that
4 it was a problem, and there is zero evidence. You look
5 at all these briefs; there isn't a citation to anything
6 in the administrative record that suggests that the
7 Federal and State programs can't work in harmony. And
8 FERC made a finding that they can work in harmony.

9 Now, with respect -- just one point on
10 arbitrary and capricious, and I'd like to sum up.

11 I think if you're going to look at one thing
12 in terms of the concern you've raised, Justice Kennedy,
13 I would look at page 223 of the Appendix to the
14 petition -- of our petition, and what you will see right
15 there is FERC directly identifying the problem that my
16 friend spent the last few minutes of his argument on,
17 and then going on to say -- and then going on to explain
18 in great detail for several pages why that critique is
19 wrong, and citing in particular the paragraph of
20 Dr. Khan's declaration where Dr. Khan is responding to
21 the specific critiques that my friend made.

22 So it -- it certainly meets the threshold
23 test of -- of -- of an adequate explanation for a
24 decision.

25 Now, if I could sum up, I think this is what

1 this case comes down to.

2 On one side of the scale, you've got a
3 practice that saves billion -- that has saved billions
4 of dollars in wholesale costs and will save billions of
5 dollars, and it's an effective tool against blackouts
6 and brownouts, and that nobody has shown in the real
7 world does any harm.

8 You have a statutory provision that gives
9 FERC specific authority to regulate this practice.

10 You have no statutory provision precluding
11 it.

12 You have Chevron in case there's any doubt.

13 And you -- and you have, really, a strong
14 cooperative Federalism program here in which States have
15 the -- States are masters of their own fate. Whether --
16 whether customers in a State participate or not is up to
17 the State. If the State thinks this is not a good
18 policy, the State can say it doesn't operate in our
19 State.

20 On the other side of the scale, what you've
21 got is an argument that all those benefits have to be
22 extinguished, and -- and no argument in the record that
23 there was any harm from this program. You have no clear
24 statutory text for bidding FERC from engaging in this
25 regulatory practice.

1 And my friend used the phrase "one size fits
2 all." Well, I -- I suggest that really what we've got
3 here on the other side is a faux Federalism argument.
4 Their argument is the one size fits all.

5 There are lots of States out there that want
6 their consumers, want their citizens to participate in
7 this because they think it's good policy and it's
8 completely harmonious with their regulation. But what
9 my friend's argument does is wipe that out and say, no,
10 it's one size fits all, and then what's -- and that one
11 size that fits all is that nobody can participate, not
12 even the 24 States that want to do it.

13 Thank you.

14 CHIEF JUSTICE ROBERTS: Thank you, General.

15 The case is submitted.

16 (Whereupon, at 12:07 p.m., the case in the
17 above-entitled matter was submitted.)

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