

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:

25 GEN. DONALD B. VERRILLI, JR., ESQ., Solicitor General,

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 the distinction. We have to make a distinction.
4 Can you tell us what the distinction is that marks the
5 end of the Federal power and the beginning of local
6 power?

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

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

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

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

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

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

23 GENERAL VERRILLI: So -- I think three
24 points to be made in response to that argument, Justice
25 Scalia. First, the -- the authority that's exclusively

1 reserved to States by Section 824(b) of -- of the
2 Federal Power Act is the authority over retail sales.
3 Every retail sale that occurs in the regime in the -- in
4 FERC's -- under FERC's wholesale demand response regime
5 is a retail sale that will occur at the rate that the
6 State regulator has set, and under the terms and
7 conditions that the State regulator has set, every
8 single sale that occurs that is true about.

9 Second, what they have said is that this
10 changes the effective rate. But what I would say in
11 response to that, Your Honor, is that if I go out and
12 buy a Ferrari for \$100,000, everybody thinks that the
13 price of the Ferrari is \$100,000. Nobody thinks that
14 the price of the Ferrari is actually \$107,000 because
15 I'm foregoing the \$7,000 tax credit I can get if I
16 bought an electric car. The rate is what it is. It's
17 \$100,000. And here, the rate is what it is.

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

25 JUSTICE SCALIA: Oh, yes, ultimately, but

1 the question is whether that is achieved by the means of
2 directly managing retail rates. And you say this does
3 not. What if FERC --

4 GENERAL VERRILLI: Those --

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

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

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

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

1 prevent -- allow wholesale operators to prevent
2 blackouts and brownouts in their --

3 CHIEF JUSTICE ROBERTS: But it's still based
4 on direct price regulation of the retail rate. It may
5 be the same point as your Ferrari hypothetical, but
6 if -- if FERC is basically standing outside McDonald's
7 and saying, we'll give you \$5 not to go in, and the
8 price of the hamburger is \$3, somebody goes up there,
9 there -- the price of a hamburger is actually, I think
10 most economists would say, \$8, because they give up the
11 \$5, they've still got to pay the \$3.

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

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

24 But ultimately it remains up to the States
25 because FERC takes State law as it finds it here,

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

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

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

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

23 GENERAL VERRILLI: Well, it seems to me,
24 Your Honor, that that's not an argument that goes to
25 FERC's jurisdiction. That may be an argument, although

1 no one has made it in this case, that if FERC believes
2 that this practice is -- that this practice is required
3 to have a just and reasonable wholesale rate, that --
4 that FERC can't then let States opt out.

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

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

12 GENERAL VERRILLI: No, Your Honor -- I know
13 --

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

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

1 that is, under the logic of New York v. FERC,
2 permissible exercise of -- of FERC's authority.

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

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

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

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

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

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

25 GENERAL VERRILLI: It's wrong as a matter of

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

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

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

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

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

1 JUSTICE SCALIA: I mean, I like deregulated
2 markets. But the -- the problem is, do you have the
3 authority to do it?

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

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

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

25 GENERAL VERRILLI: I think -- I think the

1 limiting principle has worked quite well in D.C. Circuit
2 for years now is that the effects have to be direct.
3 And it's a limiting principle akin to the kind of
4 limiting principle -- common sense limiting principle
5 that the Court has used in the ERISA preemption
6 contracts with respect to relating to.

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

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

24 It -- but when you're talking about conduct
25 that occurs in the wholesale auction in the wholesale

1 market, it's just at the core of the practices affecting
2 jurisdiction that the statute --

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

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

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

1 doing it.

2 GENERAL VERRILLI: That -- that -- that's
3 correct, Justice Sotomayor. And if I -- I would like to
4 make one point and then reserve the balance of my time,
5 if I could.

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

11 Thank you.

12 CHIEF JUSTICE ROBERTS: Thank you, General.
13 Mr. Phillips.

14 ORAL ARGUMENT OF CARTER G. PHILLIPS
15 ON BEHALF OF THE PRIVATE PETITIONERS

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

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

24 It's not a market that covers the entire
25 United States. It covers less than half the States.

1 But it is an important market that was created in order
2 to create a basis for competition.

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

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

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

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

1 And then once you do that, then is this --
2 you know, it's not: Does it affect the retail rate?
3 Clearly it will. The question is: Did what FERC do
4 here in the order directly affect the wholesale rate?
5 And on that score, it seems to me there's no question.

6 Then the issue becomes what --

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

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

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

23 There's no way to doubt that if I reduce
24 supply, that that will in -- or if I -- yeah. If I
25 reduce supply, that will cause the -- the rates, the

1 wholesale rates to drop as a natural consequence.

2 JUSTICE KENNEDY: I don't mean to jumped
3 forward too -- too quickly to, really, the second
4 question, did FERC comply with its obligation to explain
5 the -- the reason for its change, but it -- it does seem
6 to me that -- that they come close together.

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

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

14 JUSTICE KENNEDY: I mean, there are two
15 parts to this argument: One is jurisdiction; the other
16 is whether --

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

23 And what the FERC said was, when we had
24 experience with one of the regional transmission
25 operations, what happened when they reduced the price?

1 The amount of the demand response dropped precipitously.

2 And as a consequence of that, based on that
3 experience, we now have enough evidence by which to say,
4 wait a second, we need to go back and raise the price in
5 order to bring in more of the demand response, in order
6 to ensure that there is a reasonable balance between the
7 supply and the -- and the demand. But all of that's in
8 the wholesale market.

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

13 The State --

14 CHIEF JUSTICE ROBERTS: The problem is --

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

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

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

25 If I -- if -- if \$5 -- we'll give you \$5 not

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

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

8 The intention here is to try to
9 manipulate -- not to manipulate, but to control --

10 JUSTICE KENNEDY: It may not be --

11 MR. PHILLIPS: -- the wholesale rates in a
12 way that would not --

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

15 MR. PHILLIPS: Right. But -- but the
16 statute --

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

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

25 And so the fact that there are going to be

1 effects on the retail rates doesn't deprive FERC, which
2 ultimately is the supreme authority here, as long as it
3 operates within the sphere of adopting -- of dealing
4 with a practice, regulating a practice that will in fact
5 affect the wholesale rates. And that's precisely what
6 it has tried to do in this particular context.

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

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

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

1 That was what prompted, frankly, the initial
2 effort to deal with this entire demand response issue,
3 was to figure out what are we going to do about
4 brownouts? What are we going to do about blackouts?
5 How are we going to be able to -- because we can't do it
6 if we just do it on the -- on the -- on the generation
7 side.

8 We need to reduce the demand in order to
9 ensure that in response to these kinds of crises, there
10 is an answer.

11 This is the answer. Commission has operated
12 exactly the way it ought to have under these
13 circumstances.

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

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

23 JUSTICE SCALIA: But they're not all
24 generators I don't think.

25 MR. PHILLIPS: They're pretty -- I mean,

1 there's a substantial number of them. I mean, the vast
2 majority of them on the other side are -- are
3 generators, Your Honor.

4 JUSTICE SCALIA: Well, maybe your
5 colleague can -- can answer it.

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

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

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

21 If there are no further questions, Your
22 Honor. Thank you.

23 CHIEF JUSTICE ROBERTS: Thank you,
24 Mr. Phillips.

25 Mr. Clement.

1 ORAL ARGUMENT OF PAUL D. CLEMENT

2 ON BEHALF OF THE RESPONDENTS

3 MR. CLEMENT: Mr. Chief Justice, and may it
4 please the Court:

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

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

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

25 Now, that sure sounds like something that

1 belongs to the States. So the answer you hear --

2 JUSTICE SOTOMAYOR: Where is that --

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

4 JUSTICE SOTOMAYOR: Where is that in --

5 written anywhere that that was their goal? That's how

6 you've characterized that goal. But what I've heard

7 them say is, we're trying to lower the price of

8 wholesale to a more just amount. That's what's in

9 anything I've seen written. You've recharacterized it.

10 MR. CLEMENT: I don't think it's just a

11 characterization battle ultimately. But even if you

12 want to stipulate that they are trying to reduce retail

13 demand for the best of wholesale reasons, it's still --

14 JUSTICE SOTOMAYOR: They're not in the

15 retail market.

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

17 JUSTICE SOTOMAYOR: They're -- they're

18 generators selling to intermediaries. The

19 intermediaries are the ones who are in the market with

20 the retailers.

21 MR. CLEMENT: That's not correct, Justice

22 Sotomayor. It's crystal clear, and I don't think the

23 Solicitor General will contradict me in his rebuttal,

24 that what FERC does uniquely in this context is invite

25 retail customers, directly large retail customers --

1 JUSTICE BREYER: That's true. That is true.
2 That --

3 MR. CLEMENT: -- directly on the wholesale
4 exchange.

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

12 But I thought that their motivation here is
13 the following: On the 4th of August at 4:00 p.m.,
14 people turn on electricity for air-conditioning. That's
15 the peak hour. The industry, leaving reserves out of
16 this as a fixed matter, has to supply that. So if there
17 are not enough generators at 4:00 p.m. on August the
18 4th, they have to build one.

19 And to build an additional generator -- I
20 don't know what gas costs now, but let's imagine it's
21 \$500,000, and that will be passed on in the wholesale
22 price, and then probably, though the States are free to
23 do what they want, in the retail price.

24 So FERC thinks I have another way of doing
25 this. For only \$400,000, I can be sure that on the 4th

1 of August at 4:00 p.m., the demand is not great enough
2 to spend the 500, and so we group the people who will
3 promise to fulfill their air-conditioning at other
4 times.

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

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

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

1 JUSTICE BREYER: It didn't affect -- it
2 didn't try -- what it said was, we have a group of
3 people who will put customers together, and those
4 customers will, in fact, cut demand at 4:00 p.m. on
5 August 4th. As I say, that affects retail price; so
6 does everything.

7 MR. CLEMENT: But -- but --

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

11 MR. CLEMENT: I -- I --

12 JUSTICE BREYER: -- the difference here and
13 what I just said? Everything.

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

23 The only -- the saving grace for them is,
24 ah, but we're limiting ourselves to the wholesale
25 market, and we're the wholesale regulator. So why

1 shouldn't we do it?

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

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

21 If they did that, I don't think there is any
22 question that that would be a retail sale that could
23 only be regulated by the States. And if that actually
24 happened, then the RTOs and ISOs would have to make a
25 choice. They would either open themselves up to

1 regulation simultaneously by FERC and the States for
2 that retail transaction, or they would do what I think
3 they probably would do, which is, one regulator is
4 plenty.

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

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

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

1 JUSTICE SOTOMAYOR: But they all -- each of
2 them affect each other.

3 MR. CLEMENT: But here's the problem --
4 yeah, normally they stay away from each other and each
5 other's customers.

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

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

1 at huge LMP levels, then we're going to be crowded out.

2 Now, the only response that FERC can offer
3 to that is, well, then just opt-out, come on, you know.

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

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

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

1 Federal market and get a better rate --

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

3 MR. CLEMENT: -- you're going to have to
4 take a lousier rate.

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

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

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

25 MR. CLEMENT: Well, Your Honor, there is a

1 lot in that question, but let me just respond --

2 JUSTICE KAGAN: No, all there were meant to
3 be was three examples, and I don't know how good they
4 are, but they come to mind.

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

7 (Laughter.)

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

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

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

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

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

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

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

1 better.

2 So we want to increase retail demand. So
3 here's what we're going to do: We're going to have
4 either directly or through the wholesale operators --
5 we're going to pay a bonus to people who increase their
6 retail purchases.

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

10 So their position seems to be although we
11 can pay -- we can't pay incentive payments to increase
12 retail demand, we can pay incentive payments to reduce
13 retail demand.

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

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

1 complete the answer. He said that would be a harder
2 case, but he didn't ultimately say how that would be
3 answered.

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

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

19 JUSTICE SCALIA: And they're not regulating
20 the rate of sales.

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

25 But any way you think about it, that has to

1 be the implication of their theory that there is a
2 categorical difference between --

3 JUSTICE BREYER: They have to be reasonable
4 in what they do under Chevron. It's a broadly-phrased
5 statute. What they have to do is reasonable.

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

8 MR. CLEMENT: Well --

9 JUSTICE BREYER: And -- and I -- and we're
10 not electricity regulators; they are. It's pretty tough
11 and technical.

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

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

19 And the basic division of authority in
20 201(b) of the Federal Power Act is that the Federal
21 government gets sales for resales and the States get all
22 other sales.

23 And I think it's important to recognize that
24 you really have to wrestle upfront with the 201(b)
25 question because the other side loves to talk about 205

1 and 206 in the practices affecting language. But the
2 problem with that is that 201(b) specifically says that
3 the provisions of this subchapter, which include 205 and
4 206, shall apply to sales for wholesales and shall not
5 apply to all other sales.

6 So you don't get to 205 and 206 if what is
7 being regulated front and center is a retail sale of
8 electricity.

9 JUSTICE KAGAN: Mr. Clement --

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

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

21 JUSTICE KAGAN: Do you mind, Justice
22 Kennedy, if I --

23 JUSTICE KENNEDY: No, of course.

24 JUSTICE KAGAN: Yes?

25 I mean, I take it that the -- the

1 implications of your argument is that FERC can't do
2 anything with respect to demand response; is that right?

3 MR. CLEMENT: No, that's not right. My
4 position is that FERC can't do anything with demand
5 response with retail customers. They can do demand
6 response, true wholesale demand response, which they
7 were actually doing before they went down this route and
8 around, you know, the -- the two -- early 2000s.

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

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

22 Just for completeness sake, you can also
23 have wholesale participants participate in a
24 demand/response program in the forward-capacity markets,
25 where, again, it would be the LSEs. And what they would

1 do is say, we're going to -- we're going to -- three
2 years hence, we're going to reduce our compensation --
3 or our -- our consumption by this level, and we're going
4 to do it on the local level.

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

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

25 And that's the kind of thing that States

1 have been doing since the '80s. And that's the kind of
2 things that are going to be crowded out by this
3 one-size-fits-all rule with the high LMP
4 compensation recipe.

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

9 MR. CLEMENT: Right.

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

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

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

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

25 I think as a practical matter -- I don't

1 want to -- as a practical matter, I don't think the ISOs
2 and the RTOs want to be regulated by both FERC and the
3 States. So I think what they would do is, ah, if the
4 price of having a retail customer on our otherwise
5 wholesale market is we get State regulation on top of
6 Federal regulation, then we're going to bar the door to
7 the retail customer.

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

10 MR. CLEMENT: I -- I -- I would be delighted
11 to.

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

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

1 MR. CLEMENT: But the problem with that way
2 of looking it, Justice Kagan, with all due respect, is I
3 think it looks only at 1252(f), which is the one
4 reference to what FERC's supposed to do, and it ignores
5 1252(e) where Congress recognized that the States are
6 the primary actors here.

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

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

16 The procedural objections are essentially
17 that there are all sorts of objections to using LMP as
18 the price to provide compensation.

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

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

25 And the ones that I thought were most

1 persuasive in some respects was the operators of the
2 MISO, the midwestern one, because at FERC's direction,
3 they basically spent two years trying to come up with --
4 get all the stakeholders in a room and come up with a
5 formulation -- a compensation formula that worked. And
6 what they came up with was essentially LMP minus G.

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

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

18 MR. CLEMENT: Well, I think --

19 JUSTICE SOTOMAYOR: -- when that's been
20 entrusted to the agency?

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

1 to the comments that were put before you.

2 JUSTICE SOTOMAYOR: Would you tell me which
3 one? I mean, I looked through everything that the
4 dissenter said, and there is at least one or two or
5 three paragraphs in the FEC's report on this that
6 directly explains why they chose a different route.

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

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

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

20 JUSTICE SOTOMAYOR: And they -- and they
21 recognized that, and what did they say?

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

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

25 MR. CLEMENT: Well, the way I read the --

1 the way I read the record, Your Honor, is that there was
2 no response to that hypothetical, just as there was no
3 response in the SG's --

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

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

11 And to whatever extent they --

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

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

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

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

1 MR. CLEMENT: Sure. Well, I would -- I
2 would -- I would encourage you to look at the FTC
3 comments, the Joint Appendix page 281, the comments of
4 the States.

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

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

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

19 MR. CLEMENT: Yes. Yes.

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

22 MR. CLEMENT: Yes.

23 JUSTICE BREYER: Right? Okay.

24 MR. CLEMENT: And -- and -- and what I would
25 say beyond that about the net benefits test is here's

1 another way in which the -- the compensation formula is
2 what I would call substantively arbitrary and
3 capricious.

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

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

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

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

1 other out, and everybody goes home happy.

2 But when you invite retail customers on and
3 say, guess what, we're going to pay you not to buy, that
4 creates a market imbalance.

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

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

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

1 But nobody is going to offer me 40 for the
2 option to buy at 20 just because the market price is at
3 40. But that is exactly what FERC has done by setting
4 the compensation rate at LMP.

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

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

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

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

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

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

25 MR. CLEMENT: Please read -- please read

1 Dr. Hogan as well, because I really do think he has the
2 better of this argument.

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

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

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

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

18 Thank you.

19 CHIEF JUSTICE ROBERTS: Thank you, counsel.
20 Five minutes, General.

21 REBUTTAL ARGUMENT OF GEN. DONALD B. VERRILLI, JR.

22 ON BEHALF OF THE FEDERAL PETITIONER

23 GENERAL VERRILLI: Thank you, Mr. Chief
24 Justice:

25 Starting on the jurisdictional issue with

1 text, my friend pointed to Section 824(b), which you can
2 find at 1(a) of the appendix to our brief.

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

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

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

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

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

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

1 And this is really no different because
2 demand response entities that want to come in and
3 participate can only do so if their State law allows
4 them to do so. So it's no different than what's been
5 going on in the real world for quite a long time.

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

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

23 But FERC addressed that issue specifically.

24 Now, the idea that demand response can't
25 work, the State-level demand response, retail demand

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

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

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

24 So it -- it certainly meets the threshold
25 test of -- of -- of an adequate explanation for a

1 decision.

2 Now, if I could sum up, I think this is what
3 this case comes down to.

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

10 You have a statutory provision that gives
11 FERC specific authority to regulate this practice.

12 You have no statutory provision precluding
13 it.

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

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

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

1 statutory text for bidding FERC from engaging in this
2 regulatory practice.

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

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

15 Thank you.

16 CHIEF JUSTICE ROBERTS: Thank you, General.

17 The case is submitted.

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

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<p style="text-align: center;">A</p> <p>a.m 1:23 4:2 ability 5:22 33:25 able 24:5 above-entitled 1:21 59:19 absolute 18:16 accept 29:12 accepted 8:15 15:12 account 11:24 51:16 accounts 53:8 achieve 6:18 8:25 achieved 8:1 achieving 6:17 acknowledgment 11:15 Act 4:12 7:2 18:23 29:22 32:20 36:13 37:7 40:20 42:17 42:18 45:21 action 5:10 56:21 actions 4:18 13:5 actors 8:23 13:10 44:7 46:6 actual 17:22 51:6,8 52:18 add 28:10 additional 9:18 28:19 address 45:9 54:10 addressed 48:10 56:10,10,23 adds 28:10 adequate 41:14 57:25 adequately 47:25 adjustments 52:7 administrative 57:5,8 administratively 49:22 adopt 53:14 adopted 18:4 adopting 23:3</p>	<p>affect 5:11 14:15 19:2,4,9,13,17,19 23:5 30:1 33:2 34:10 35:16,16 38:9 affirmatively 50:8 agencies 47:13 56:17 agency 13:18 47:20 agree 5:9 10:3 16:8 25:9 43:19,22 agreement 24:15 ah 30:24 45:3 air-conditioning 28:14 29:3 akin 15:3 AL 1:8,12,16 allow 8:25 9:1 20:18,20 23:21 34:14 35:9 36:16 39:15 allowed 20:12 allows 34:6 38:17 56:3 alluded 46:20 amicus 25:7 amount 8:9 21:1 27:8 amounts 7:22 analogy 35:23 anomaly 32:19 33:6 34:4 38:20 answer 9:12 24:10 24:11 25:5 27:1 31:12 38:25 39:1 44:15 answered 39:3 answers 5:8 anybody 44:21 appear 37:14 APPEARANCES 1:24 appendix 50:3 55:2 57:15 apply 9:23 41:4,5 52:9 55:5</p>	<p>applying 55:14 appreciate 11:19 approach 23:10 29:23 appropriate 23:17 appropriation 39:6 approvals 35:6 arbitrary 40:17 41:13 46:12 47:23 51:2 54:6 57:12 area 11:16,17 22:22 34:5 46:8 argument 1:22 3:2 3:5,8,11 4:3,8 6:10,20,24 7:19 10:24,25 12:10 17:14 20:7,15 26:1 37:2 42:1 45:14 51:18 54:2 54:21 55:18 57:18 58:23,24 59:5,6 59:11 articulated 45:25 asked 17:19 45:9 asking 54:8 asks 18:23 asserted 6:22 Association 1:8,16 4:5 assume 41:11,13 assumes 22:4 assuredly 25:14 AT&T 13:17 auction 4:17 14:17 14:18 15:9,10,12 15:25 16:15,17,18 42:20 auctions 55:23 August 28:13,17 29:1 30:5 39:18 authority 6:25 7:2 10:10,16 11:22 12:2,7 13:13 14:3 14:8,11,14 15:23 17:8,10 21:11 23:2 34:5 36:13</p>	<p>38:16 40:19 43:15 58:11 authorized 19:11 authorizes 4:12 available 8:6 avoid 4:21,22 39:16 avoided 53:9,10 aware 33:7</p> <hr/> <p style="text-align: center;">B</p> <p>B 1:25 3:3,12 4:8 54:21 back 21:4 balance 4:19 15:13 17:4 21:6 bar 45:6 barriers 45:23 based 9:3 21:2 43:21 basic 40:19 basically 9:6 21:17 37:1 43:18,22 47:3 basis 5:14,15 18:2 18:14 23:20 battle 27:11 beginning 5:5 behalf 2:1,3,5 3:4,7 3:10,13 4:9 17:15 26:2 54:22 believe 10:12 16:21 37:8 38:7 believes 11:1 belong 31:3,6 51:12 belongs 27:1 below-market 52:25 benefit 6:15 8:18 benefits 12:15 49:15,15 50:15,25 52:9 53:21 58:23 best 27:13 50:21 better 26:6 31:16 31:20 35:1 38:1 54:2 beyond 26:19 50:25</p>	<p>54:5 bid 4:16 42:20 bidders 15:14 bidding 33:10 44:7 59:1 bids 4:18,20 8:14 15:11,12,13 big 33:12 billing 52:6 billion 58:5 billions 12:15 58:5 58:6 bit 37:23 blackouts 4:22 9:2 24:4 58:7 bonus 38:5 boost 37:23 bought 7:16 52:19 boundary 29:22 bounds 31:9 54:5 bounty 38:23 breaking 47:9 BREYER 28:1,5 30:1,8,12 35:2,5 36:18 40:3,9 49:12 50:17,20,23 53:19 bridge 14:5 brief 19:21 37:16 43:9,11 45:18 46:8 48:16,16 50:18,21 52:15 55:2 briefs 13:12 25:7 57:7 bring 13:9 21:5 46:12 brings 12:14 broadly-phrased 40:4 brought 13:10 brownouts 4:22 9:2 24:4 39:17 58:8 build 28:18,19 built 51:4 bunch 37:24 49:18</p>
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