The federal-state energy regulatory divide: The new order after Learjet, EPSA and Hughes

July 5, 2016

In three recent decisions (the Three Decisions), the US Supreme Court (the Court) drew a sharp dividing line between the authority of the Federal Energy Regulatory Commission (FERC or Commission) and that of the states to regulate the nation's electric and natural gas industries under the Federal Power Act (FPA) and the Natural Gas Act of 1938 (NGA). The impact of these decisions on the future of energy regulation will be felt by project developers, investors, lenders, utilities, consumers and state and federal regulators for years to come.

This article proceeds in four parts: (i) review of the FPA and NGA allocation of authority to regulate electric energy and natural gas that was the focus of the Court in the Three Decisions; (ii) a brief description of the two forms of federal preemption; (iii) a summary of the Three Decisions; and (iv) a framework for analyzing the Three Decisions and future cases which can help clarify future questions of jurisdiction and preemption.

1. Subdividing the jurisdictional divide: FPA and NGA

EPSA and Hughes fall under the FPA. Learjet falls under the NGA.

Under the FPA, FERC has jurisdiction over “sales for resale” of electric energy and the transmission of electric energy in interstate commerce, the term “in interstate commerce” being defined differently from what it has come to mean under the Commerce Clause. FPA Section 201(c) defines “in interstate commerce” to mean electricity produced in one state that is consumed anywhere outside of the state (within the United States). The Court long ago affirmed FERC’s exercise of jurisdiction based on the “co-mingling” of electric energy. Electric energy travels at the speed of light (186,000 miles per second). Once electric energy enters the interstate electric transmission grid it becomes co-mingled with other energy on the grid and then follows the laws of physics without regard to the geographic dividing lines of states, or the paths specified in contracts. On this basis, with limited exceptions, FERC has jurisdiction over wholesale sales (sales for resale) and transmission on the interconnected grid.

In contrast, part of Texas is electrically isolated from the rest of the interconnected grid, and wholesale transactions and transmission are generally not subject to FERC jurisdiction. FERC also does not have jurisdiction over any other sales of electric energy (comprising retail sales), and over generation siting or local distribution of electric energy, which includes bundled retail sales of energy and the lower voltage local delivery of energy usually to retail or end-use customers.

Under the NGA, FERC, similar to under the FPA, has jurisdiction over certain wholesale sales of natural gas and the transmission of natural gas in interstate commerce. FERC does not, however, have jurisdiction over retail sales or distribution of natural gas. The transport of natural gas is different than the transport of electricity because gas can be transported intrastate, and the NGA specifically reserves this field for state jurisdiction.
Under both the FPA and NGA, FERC has jurisdiction over matters affecting jurisdictional rates and services. The FPA provides:

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.[10]

Similarly, the NGA provides:

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.[11]

The Court has held that FERC’s jurisdiction under the “affecting” clause (referred to below as “FERC Indirect Jurisdiction”) is not unbounded. Rather, as the Court held in EPSA, it is limited to “rules or practices that ‘directly affect the [wholesale] rate.”[12]

In making initial jurisdictional determinations, it can be important to identify whether jurisdiction is derived from an explicit statutory grant of regulatory authority over the specific subject matter FERC is regulating (FERC Direct Jurisdiction), or whether it derives from the above-quoted FPA and NGA provisions, which give FERC authority to regulate matters “affecting” jurisdictional services or rates (FERC Affecting Jurisdiction or FERC Indirect Jurisdiction).

Of equal importance in this process is determining whether the subject matter FERC seeks to regulate falls under the FPA and NGA provisions that explicitly preserve the subject matter of the regulation for the states.[13] We refer to both of these clauses, respectively, as “state savings clauses” and describe them as reserving for the states jurisdiction over specified activities (State Reserved Jurisdiction).[14] Finally, there are activities that affect matters within State Reserved Jurisdiction and that states sometimes regulate (State Indirect Jurisdiction), but the FPA and NGA do not explicitly reference State Indirect Jurisdiction (or State Affecting Jurisdiction). This article examines the three jurisdictional categories articulated in Sections 201, 205 and 206 of the FPA[15] and Sections 1, 4 and 5 of the NGA[16] (i.e., FERC Direct Jurisdiction, FERC Indirect Jurisdiction and State Reserved Jurisdiction) as well as the fourth category not explicitly addressed in the statutes, State Indirect Jurisdiction.

2. Federal preemption

When FERC is acting within its jurisdiction to regulate an activity, if a state seeks to regulate the same activity, it becomes necessary to determine whether the state regulation is federally preempted. There are two forms of federal preemption—“field preemption” and “conflict preemption.” The former precludes state regulation of subject matter when Congress has fully occupied the field.[17] The latter permits state regulation of a subject FERC is regulating or over which FERC has jurisdiction, provided the state regulation does not interfere with FERC’s regulation of the same subject.[18]

Not all of the appellate decisions in energy cases that have involved jurisdictional disputes and preemption have been clear about whether the basis for FERC jurisdiction was direct or indirect or the basis for state jurisdiction was direct or indirect. Yet the form of jurisdiction informs the preemption analysis. When the basis for FERC action is the “affecting clause” (FERC Indirect Jurisdiction), the potential for state regulation of the same subject matter may be present, as was the case in Learjet.[19]

Similarly, not all of the appellate decisions in energy cases concerning federal-state regulatory disputes have been clear about whether the preemption determination was field- or conflict-based. This article analyzes the Three
Decisions to clarify the methodology for analyzing such disputes.

The following table presents a simple framework for depicting the possible permutations for resolving federal-state disputes under the FPA and NGA.

<table>
<thead>
<tr>
<th>FERC-State Jurisdiction Preemption Matrix (unpopulated)</th>
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Each of the four empty cells in our Matrix can be populated with “field preemption,” “conflict preemption” or “no preemption.” Following brief summaries of the Three Decisions, we set out to populate the table below.

### 3. The Three Decisions

#### a. Learjet

*Learjet* was the first of the trilogy. FERC regulates certain wholesale sales of natural gas under the NGA. Many wholesale sales were priced based on natural gas price indices. After becoming concerned that some market participants were manipulating the price of natural gas through false or misleading disclosures to index publishers, FERC adopted regulations to prevent manipulation of indexes and related prices.  

In three states, large end-use customers of interstate pipelines brought antitrust actions under state law. The pipelines removed the state cases to federal court, where they were consolidated and sent for pretrial proceedings to the Federal District Court for the District of Nevada. The plaintiffs’ claims included damages resulting from alleged unlawful manipulation of indices on which the plaintiffs’ retail (end use) natural gas prices were based. Certain defendants moved for summary judgment to dismiss the complaints, arguing that field preemption barred the suits based on FERC’s regulation of the gas indexing practices which affect wholesale prices of gas. The District Court granted the motions. The US Court of Appeals for the Ninth Circuit reversed on the grounds that the complaints sought redress for only impacts on retail sales of gas. The Supreme Court reversed and remanded the case on the grounds that FERC was not regulating wholesale sales of gas but rather practices that affect wholesale sales of gas (and also retail sales of gas) Under the circumstances of Learjet, the Court found that the lower court should have analyzed the case under the conflict preemption doctrine.

Learjet involved matters affecting both FERC-jurisdictional wholesale sales and state-jurisdictional retail sales of natural gas. Accordingly, within our Matrix, Learjet is a double-Indirect case in which the Court found that conflict preemption analysis applied. Under conflict preemption, state regulation may coexist with FERC regulation of the same subject matter so long as the state regulation does not interfere with FERC regulation.

In his dissent, the late Justice Scalia, with Chief Justice Roberts joining, criticized the majority for deviating from Court precedent holding that if FERC regulated a subject within its jurisdiction, the states were precluded from regulating it, either before a state commission or, as in this case, an antitrust court. The dissent went on to warn that some companies will be subject to regulation or litigation in multiple states as well as at FERC, all concerning the same subject matter. Without broader application of field preemption, there will be more cases filed over

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[20]: Footnote reference.
[21]: Footnote reference.
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whether state regulation conflicts with FERC regulation and is thus conflict preempted.

b. EPSA

The second of the Three Decisions was EPSA. FERC regulates the rates, terms and conditions by which demand response participants participate in the independent system operator/ regional transmission organization (ISO) markets. FERC required ISOs to pay full locational marginal price for energy for demand response which curtailed load as part of an economic demand response program. In a two-to-one split decision, the US Court of Appeals for the DC Circuit held that FERC lacked jurisdiction over demand response because it occurs in the retail market. On the same day the court issued its opinion, FirstEnergy Service Co., a subsidiary of FirstEnergy Corp., filed a complaint at FERC seeking to remove all PJM tariff provisions permitting demand response to participate in the PJM capacity market. This was no small matter. The independent market monitor for PJM estimated that in one year, demand response cleared 10,000 MW of capacity and reduced market-wide capacity costs by $9 billion. Later in 2014, the New England Power Generators Association filed a complaint seeking similar prohibitions in ISO-New England.

The Court reversed the DC Circuit, upholding FERC’s jurisdiction over demand response participation in the wholesale energy market. The DC Circuit did not present a plain textual analysis of the FPA in the majority opinion. It relied on a generalization of the FPA’s state savings clause. A plain text interpretation of the FPA might have focused on whether the sale of curtailment service to a demand response aggregator or load serving entity for offering into an ISO market in lieu of supply side energy or capacity constituted a retail sale of electric energy or local distribution (either a bundled retail sale of electricity or the local, lower voltage delivery of energy).

While the Court did not go through a detailed statutory textual analysis, it clearly rejected the DC Circuit’s holding that demand response was subject to the FPA's state savings clause. Interestingly, the DC Circuit held that FERC’s interpretation of the FPA was not entitled to Chevron deference, referring to the deference courts normally show to an agency’s interpretation of a statute it implements. The majority held that FERC’s interpretation was inconsistent with the statute and therefore the agency was not entitled to such deference. Further, the majority added, there was no need to apply Chevron deference because FERC’s jurisdiction was so clear.

The issue before the Court was whether FERC lacked jurisdiction, not whether the FPA preempted state regulation of demand response. The Court did not reach the preemption issue, but held that FERC may act because the subject of FERC regulation did not fall under the state savings clause (i.e., State Direct Jurisdiction).

There is no doubt that demand response affects very directly the price of energy and capacity in the wholesale market. At the same time, offers of demand response and curtailment are not sales for resale of electric energy because they involve curtailment of retail (end use) purchases. Consequently, both Learjet and EPSA appear to involve matters affecting both FERC-jurisdictional wholesale sales and state-jurisdictional retail sales of natural gas (Learjet) and electricity (EPSA). For purposes of our Matrix, EPSA appears to be a “double-Indirect case.” If so, then were there a dispute between FERC and state regulation of demand response, it remains to be seen whether conflict preemption analysis applies as it did in Learjet.

c. Hughes

The third of the Three Decisions was Hughes, in which the Court found that the state of Maryland had crossed the line in regulating the rate or price received for sales for resale of electric capacity in interstate commerce, an area subject to FERC’s jurisdiction. Maryland regulators were concerned that new generation was not locating where and when needed. The Maryland Public Service Commission required state-jurisdictional electric distribution companies (EDCs) to enter into contracts for differences (CFDs) such that if the PJM (ISO) capacity clearing price the generator would...
receive were below the CFD price, each EDC would pay the generator the difference, and if the PJM capacity clearing price were greater than the CFD price, the generator would pay the EDC.\[38\]

The Court affirmed the findings of the district court and the U.S. Court of Appeals for the Fourth Circuit, holding that the CFDs established by Maryland were preempted.\[39\] The Court indicated that the holding was limited.\[40\] In particular, the Court observed that the CFDs included an obligation by the generator to clear the PJM capacity auction so the CFDs effectively set the capacity price for selling wholesale capacity to PJM, the CFDs were obligatory and not necessarily entered into voluntarily by the EDCs; and did not constitute separate sales of capacity and energy which would have been filed with FERC for review.\[41\]

In \textit{EPSA}, the Court applied a narrow interpretation of what it meant to set rates for retail sales and on this basis found that demand response did not fall under the State Savings Clause and reversed the DC Circuit. In contrast, in \textit{Hughes}, the Court applied a broader interpretation of what it meant to set the price for a wholesale sale of electric capacity. The Court could have determined that CFDs are merely hedges and are not setting the price of capacity and energy in the PJM capacity auctions. Had the Court pursued this route, the case would have fallen within the \textit{Learjet}-like double-Indirect category. Instead, \textit{Hughes} is a FERC Direct Jurisdiction/State Direct Jurisdiction case. Without discussing Field Preemption and Conflict Preemption, the Court apparently applied Field Preemption. In discussing the issues the Court did not reach, the Court indicated it did not address the Fourth Circuit’s alternative finding that the state regulation interfered with the FERC jurisdictional wholesale market, a finding relevant under Conflict Preemption.\[42\]

4. The FERC-State Jurisdiction Preemption Matrix and a taste of things to come

Based on the analysis presented above, the Three Decisions can be placed in the FERC-State Jurisdiction Preemption Matrix (the Matrix) presented below. The Matrix is followed by an explanation of why.

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<td></td>
</tr>
<tr>
<td>State Indirect Jurisdiction</td>
<td></td>
<td>\textit{Learjet} - conflict preemption \textit{EPSA} - not a preemption case</td>
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\textit{Learjet} is placed in the double-Indirect cell, and conflict preemption applies. This is beyond question because the Court made it clear that the regulation and creation of gas index publishing was not the regulation of either a wholesale or retail sale of natural gas under FERC or state jurisdiction, respectively. Rather, the Court found that the subject of regulation affected both.\[43\] Under these circumstances, the Court reversed the Ninth Circuit’s holding because conflict preemption analysis should have been applied to the state regulation (in the form of antitrust cases) to determine if it interfered with FERC regulation.

\textit{EPSA} is placed in the double-Indirect cell. The Court found: “First, the practices at issue in the Rule—market operators’ payments for demand response commitments—directly affect wholesale rates. Second, in addressing those practices, the Commission has not regulated retail rates.”\[44\] The case did not address whether a state rule
conflicted with FERC regulation of the wholesale electric market. Instead, the case was decided on jurisdictional grounds. The Court reversed the DC Circuit’s holding that FERC was regulating in an area reserved for the states—the setting of rates for retail sales of electric energy.[45] Once the Court held that FERC’s regulation of rates for demand response offered into the wholesale market did not constitute regulating the rates for retail (end use) sales of electric energy, the foundation of the DC Circuit’s decision was removed.

Preemption issues were not before the Court in **EPSA**. If a conflict between state and FERC regulation of demand response arises in the future, then it would appear likely that FERC’s jurisdiction over demand response participation in the wholesale market will be upheld so long as FERC does not cross the line of regulating the retail sale of electricity or its price (more narrowly construed than the DC Circuit construed this sphere of activity). **Learjet**, however, suggests that states may also regulate demand response, subject to Conflict Preemption analysis. Both **Learjet** and **EPSA** concerned the regulation of matters affecting both wholesale and retail rates, but not the rates or sales themselves. Were **Learjet** applied to a conflict in demand response regulation, then as long as the state regulation does not interfere with FERC regulation, there can be room for both to regulate. This is consistent with the **EPSA** Court’s citation to “cooperative federalism” noted with favor. [46]

**Hughes** is placed in the FERC Direct/State Direct cell, and field preemption applied.[47] The Court found the state-sponsored CFDs set a price for wholesale capacity, a subject falling under FERC Direct Jurisdiction.[48] The **Hughes** Court was willing to consider the state-sponsored CFDs as a form of direct state regulation of generation. The Court observed that the **Mississippi Power & Light** and **Nantahala** decisions make “clear that States interfere with FERC’s authority by disregarding interstate wholesale rates FERC has deemed just and reasonable, even when States exercise their traditional authority over retail rates or, as here, in-state generation.”[49]

The Court in **Hughes** was clear in declining to consider whether the state regulation (the forms of CFDs) interfered with the wholesale capacity market.[50] It is reasonable to interpret this as the Court’s finding that field preemption applied and that therefore there was no need to engage in a conflict preemption analysis.

The Three Decisions do not address facts involving states acting within their Direct Jurisdiction in conflict with FERC acting under its Indirect Jurisdiction. The Court in **EPSA** provides its answer in what may be termed *dicta*:

The above conclusion [that FERC was acting within its affecting or Indirect Jurisdiction] does not end our inquiry into the Commission’s statutory authority; to uphold the Rule, we also must determine that it does not regulate retail electricity sales. That is because, as earlier described, §824(b) “limit[s] FERC’s sale jurisdiction to that at wholesale,” reserving regulatory authority over retail sales (as well as intrastate wholesale sales) to the States. FERC cannot take an action transgressing that limit no matter how direct, or dramatic, its impact on wholesale rates.[51]

This is not surprising. It would be odd if a conflict between actions under FERC Indirect Jurisdiction could preempt actions under State Direct Jurisdiction. With the right facts and imperatives, it may be possible that inconsistent state regulation interferes with imperative federal regulation under FERC Indirect Jurisdiction so as to tempt the Court to apply conflict preemption. Alternatively, the Court may take an expansive view of what constitutes a wholesale sale or transmission so that it can find the case falls under FERC Direct Jurisdiction. The recent trilogy does not address this fact pattern.

**Learjet** informs us that as long as an action is not within FERC or State Direct Jurisdiction, states may regulate it even if the action significantly affects wholesale rates subject to FERC jurisdiction. **EPSA** informs us that matters over which FERC may regulate wholesale market aspects may involve the retail market. The bounds of this potential for dual regulation will be tested in the coming decade as states adjust to the Clean Power Plan (CPP) and litigate cases involving existing renewable portfolio standards and the pricing of renewable energy; demand response; and credits for low- or zero-emission energy sources.[52]
The subject of state regulation will be imperative under federal environmental regulation. The impacts these state actions will have on the wholesale market may be direct and substantial. For example, according to some nuclear power plant owners, current market prices do not justify investment to keep the plants running. Many states are making plans to comply with the CPP. The Environmental Protection Agency, in establishing required emissions reductions, assumed that existing nuclear power plants would continue to operate. If they are retired, some states will face great challenges in achieving the targeted reductions. If states offer subsidies for these nuclear power plants, it is possible issues similar to those present in Hughes will arise. Will the state subsidies establish the price the supplier receives for wholesale power and energy? Will they suppress ISO market clearing prices so as to diminish effective price signals and to harm generators which invested with the promise of a competitive market return diminished by subsidies? Many other important issues may blur the line between permissible state regulation and preemption as the U.S. electricity sector experiences revolutionary changes with respect to fuel mix and decarbonization.

Applying Learjet in this dynamic environment will provide significant challenges to regulators, energy project developers, lenders, investors and customers. The simple FERC-State Jurisdiction Preemption Matrix is a tool to consider how to organize and contrast the energy cases approaching the FERC-state divide. Unless Learjet descends, the hottest contests are likely to be decided in the double-Indirect category.

A version of this paper was first delivered at the Energy Bar Association’s Annual Meeting on June 7, 2016, where the author moderated a plenary panel, “The Court Has Spoken - What Does It Mean?”, with panelists Max Minzner, General Counsel, FERC, Clare Kindall, Assistant Attorney General, Connecticut, and Erin Murphy, Partner, Bancroft PLLC, concerning the three US Supreme Court cases.


[7] The Electric Reliability Council of Texas (ERCOT) refers to the network of interconnected utilities that together cover approximately 75% of the land area in the state of Texas. See http://www.ercot.com/about/profile/. ERCOT is generally not subject to FERC jurisdiction.


[12] EPSA, 136 S. Ct. at 774 (emphasis in original, citations omitted) (explaining that “a non-hyperliteral reading is needed to prevent the statute from assuming near-infinite breadth”).

energy[,] ... facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, [and] ... facilities for the transmission of electric energy consumed wholly by the transmitter"); 15 U.S.C. § 717(b) (reserving to the states jurisdiction over the “transportation or sale of natural gas[,] ... the local distribution of natural gas [and] the facilities used for such distribution or to the production or gathering of natural gas”).

[14] State agencies do not derive jurisdiction from the FPA or NGA. Rather, state agencies derive jurisdiction from state statutes. The FPA and NGA provisions which explicitly recognize state jurisdiction over or prohibit FERC regulation of certain subjects suggest states are free to regulate these subjects without being Federally preempted so long as the states do not regulate matters subject to FERC Direct Jurisdiction.


[18] See id.

[19] See id. at 1594, 1599.


[22] See In re Western States Wholesale Natural Gas Antitrust Litigation, 715 F. 3d 716, 729-736 (9th Cir. 2013) (¨Western States¨).


[25] See id. at 1606-08 (Scalia, J., dissenting).

[26] See id. at 1608 (Scalia, J., dissenting).


See EPSA, 136 S. Ct. at 767.

See Elec. Power Supply Ass’n v. FERC, 753 F.3d 216, 221-23.


See Elec. Power Supply Ass’n v. FERC, 753 F.3d 216, 224.

See EPSA, 136 S. Ct. at 774 n.5 (“Because we think FERC’s authority clear, we need not address the Government’s alterative contention that FERC’s interpretation of the statute is entitled to deference under Chevron ....” (citations omitted)). Absent in both decisions was a detailed analysis of the legislative history of the FPA. Typically in cases involving statutory construction, parties with opposite positions claim that each mutually exclusive position is consistent with the plain text of the statute. In the alternative, each opposing party then argues that to the extent there is an ambiguity, the legislative history supports only its interpretation of the statute. Ultimately, the Court found the statute clear in support of FERC’s jurisdiction, and there was no need to resort the legislative history.

See Hughes, 136 S. Ct. at 1297.

See id. at 1294-96.

See id. at 1296.

See id. at 1299.

See id.

See id. n.12.

See Learjet, 135 S. Ct. at 1594 (“The pipelines’ behavior affected both federally regulated wholesale natural-gas prices and nonfederally regulated retail natural-gas prices. The question is whether the federal Natural gas Act pre-empts these lawsuits.”) (emphasis in original).

See EPSA, 136 S. Ct. at 773.

See id. at 773-82.

See id. at 779.

See Hughes, 136 S. Ct. at 1298 n.11.

Capacity can be sold without actually selling energy, such as in situations where the energy is too expensive and not needed. An argument could be made that the sale of capacity affects sales of energy but does not constitute a sale of energy. For purposes of this article, we do not address this issue because it was not raised in Hughes.


See Hughes, 136 S. Ct. at 1298 n.11.

See EPSA, 136 S. Ct. at 775 (internal citations omitted).