LET'S GET 'METAPHYSICAL'

A federal court slaps down an Obama regulator's legal abuse.

President Obama's energy regulators have pushed the law to the hilt and beyond in their campaign against carbon, but maybe the courts are starting to get queasy. The latest is the D.C. Court of Appeals, which on Friday cashiered a rule meant to harm traditional power plants.

The Federal Energy Regulatory Commission (FERC) used to be the rare government outfit that preferred to stay out of the news, but under Chairman Jon Wellinghoff the legal and economic offenses in favor of noncarbon power sources piled up. The Senate is now weighing Mr. Wellinghoff's replacement, Norman Bay, and one question is whether he'll continue the regulatory method that produced the rule the D.C. Circuit has now tossed as an abuse of power.

FERC governs the electricity grid, and in 2011 Mr. Wellinghoff ordered transmission operators to pay retail energy users to reduce their power consumption at peak periods. This smart-grid program is known as "demand response" and can help run the system more efficiently and reliably. But FERC rigged this well-meaning incentive to harm traditional baseload power, especially coal but also natural gas and nuclear

The problem is that Congress limited FERC's mandate to the wholesale interstate power markets—that is, power supply. Authority over retail power *demand* is reserved to the "exclusive jurisdiction" of the states.

FERC regulated anyway, claiming that the demand-response program would "directly affect" the regional level and therefore the two distinct state and interstate spheres were essentially the same. Judge Janice Rogers Brown shreds that logic as a "metaphysical distinction." She goes on to note that FERC's rationale "has no limiting principle" because changes in one market inevitably beget changes in another. FERC could use the same rationale to claim jurisdiction over "any number of areas, including the steel, fuel and labor markets."

The D.C. Circuit ruled FERC lacked statutory authority but then took a further step and declared the demand-response rule "arbitrary and capricious" on the merits, which is unusual. The courts generally defer to the judgment of regulators, and the Administrative Procedures Act blesses all but the most egregious overreach.

Especially abusive was FERC's discriminatory compensation scheme. FERC reasoned that not consuming power was identical to adding power to the grid and therefore service providers that took advantage of demand response deserved to be paid the same full market rate as power generators. But so-called "negawatts" are different from real megawatts, not least because power producers incur the costs of actually producing electricity and sending that power to consumers. In practice, demand response paid out twice to the service providers, once from the FERC rebate plus the savings of not buying electricity. Overpaying for not doing something and underpaying for real economic benefits distorts price signals and leads to a misallocation of resources from electricity investment.

For this reason FERC Commissioner Phil Moeller dissented at the time, and economists and industry objected. Mr. Wellinghoff overruled, and FERC held that "the Commission is not limited to textbook economic analysis." The D.C. Circuit has replied that in fact it is and that the commission was harming the reliability of power markets it is supposed to protect.

On that note, Mr. Bay, the nominee for FERC Chairman, did little to distance himself from the Wellinghoff legacy when he testified on Tuesday, nor did he explain his own history of prosecutorial abuse at the commission. His answer to every question was that he didn't know, he wasn't sure, or he couldn't say.

But if Mr. Bay is confirmed, his job becomes even more important after the D.C. Circuit opinion. Over the last two years demand-response programs have suffused the grid and barring a successful appeal, which is unlikely given the sweep of the ruling, the feds will now be banned from regulating electricity demand.

Yet the forthcoming Environmental Protection Agency regulations on power plant carbon emissions—due in two weeks—will probably depend on FERC's demand-response distortion. Ending the conservation subsidies while simultaneously imposing rules that will force the retirement of existing coal power could do even more to endanger the grid and lead to rolling blackouts. West Virginia Democrat Joe Manchin asked Mr. Bay about grid reliability but he only responded that "I have not been following the decisional process at EPA closely enough to know."

The D.C. Circuit thunderclap could help restore the old nonpolitical FERC, but so would a Chairman with more fidelity to the law than Mr. Bay.