

THE ENERGY POLICY ACT OF 2005: PURPA REFORM, THE AMENDMENTS AND THEIR IMPLICATIONS

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I. INTRODUCTION

The Energy Policy Act of 2005 (EPAct 2005)¹ introduced sweeping changes to nearly every sector of the energy industry, including the electricity sector. One of the more significant provisions of EPAct 2005 is the amendment of the Public Utility Regulatory Policies Act of 1978 (PURPA or the Act).² Enacted during the Carter administration as one of five major energy bills consolidated into “the National Energy Act,” PURPA sought to promote energy efficiency and encourage the use of alternative fuels to lessen the nation’s dependence on foreign oil.³

This article addresses one of the main aspects of PURPA, codified at section 210 of the Act, which, together with the implementing regulations promulgated by the Federal Energy Regulatory Commission (the FERC or the Commission), established a class of generators known as “qualifying facilities” (QFs) and provided them certain benefits and exemptions in order to encourage their development. Although each of the other components of the National Energy Act has been repealed, and PURPA section 210 has been the subject of repeal efforts,⁴ PURPA continues in effect as amended by EPAct 2005. This article describes the statutory and regulatory framework established under section 210 of PURPA and the FERC’s implementing regulations, as well as the changes to that framework effected by the provisions of EPAct 2005 and regulations recently issued by the Commission implementing some of those provisions. This article also examines potential implications of PURPA reforms initiated by EPAct 2005.

II. BACKGROUND AND HISTORY

A. *The Public Utility Regulatory Policies Act of 1978*

The National Energy Act, including PURPA, embodied the Carter

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1. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594.

2. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117.

3. The other energy bills were: (1) Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350; (2) Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289; (3) National Energy Conservation Policy Act, Pub. L. No. 95-619, 92 Stat. 3206 (1978); and (4) Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174.

4. For example, “[o]n June 6, 1995, the Energy Production and Regulation Subcommittee of the Senate Energy and Natural Resources Committee, chaired by Senator Don Nickles (R-OK), held a hearing on S. 708, The Electric Utility Ratepayer Act, which would [have] repeal[ed] Section 210 of PURPA.” MICHAEL J. ZUCCHET, DEP’T OF ENERGY, RENEWABLE ENERGY ANNUAL 1995: RENEWABLE RESOURCE ELECTRICITY IN THE CHANGING REGULATORY ENVIRONMENT XXIX (1995), available at <http://tonto.eia.doe.gov/FTP/ROOT/renewables/060395.pdf> (footnote omitted).

administration's response to the energy crises of the 1970s, most notably the Middle East oil embargo of 1973–74 and a second oil “shock” in 1977.⁵ Following those events, the administration and Congress sought to create a statutory framework to facilitate the diversification of America's energy supplies and to reduce the nation's dependence on imported oil, among other objectives. Congress intended PURPA to foster energy efficiency in an environmentally friendly manner by establishing incentives for the development of cogeneration facilities and small-scale renewable power projects.⁶ PURPA's incentives included the creation of markets for the power produced by these facilities and the exemption of the facilities from most state and federal utility regulation.

1. Qualifying Facilities

PURPA and the Commission's implementing regulations established the standards for the certification of a cogeneration facility or small power production facility as a “qualifying facility” entitled to the incentives and exemptions under the Act. The standards for QF certification cover the types and performance of facilities eligible for certification, as well as limitations on their ownership by electric utilities and electric utility holding companies. Although EPAct 2005 substantially modifies or eliminates the original standards developed by the FERC for QF status, many of the original standards will continue to apply to existing QFs, and are therefore described in this section and in the following section.⁷

Facility-Related Conditions. PURPA delegated to the FERC responsibility to develop rules for the eligibility for QF status of small power production facilities and cogeneration facilities.⁸ Under the FERC's regulations in effect on August 8, 2005, when EPAct 2005 became law (the FERC's original QF regulations), a small power production facility was “qualifying” if it satisfied the QF ownership requirements, described in the next section, and if (1) its primary energy source (i.e., at least 75% of its energy input) was from biomass, waste, renewable resources, geothermal resources, or any combination of the foregoing;⁹ and (2) its total net power production capacity, together with any other facilities at the same site, was not greater than 80 megawatts¹⁰ or it was an “eligible solar, wind, waste or geothermal facility” of any size.¹¹

5. See Richard D. Cudahy, *PURPA: The Intersection of Competition and Regulatory Policy*, 16 ENERGY L.J. 419, 421 (1995).

6. *Id.* at 421–22; see also AMY ABEL, CONGRESSIONAL RESEARCH SERVICE, CRS REPORT FOR CONGRESS, ELECTRICITY RESTRUCTURING BACKGROUND: THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978 AND THE ENERGY POLICY ACT OF 1992 (1998), available at <http://ncseonline.org/NLE/CRSreports/energy/eng-36.cfm?>.

7. EPAct 2005 does not alter facility-related criteria applicable to any cogeneration facility that “(A) was a qualifying cogeneration facility on the date of enactment of [the PURPA amendments], or (B) had filed with the Commission a notice of self-certification, self-recertification or an application for Commission certification under 18 CFR 292.207 prior to the date on which the Commission issues the final rule” implementing the changes to the criteria applicable to cogeneration facilities. Energy Policy Act of 2005 § 1253(a), 119 Stat. at 970 (adding § 210(n)(2) to the Public Utilities Regulatory Policies Act of 1978).

8. Public Utilities Regulatory Policies Act of 1978 §§ 201(17)(C), 201(18)(B), 16 U.S.C. §§ 796(17)(C), 796(18)(B) (2000).

9. 18 C.F.R. § 292.204(b) (2005).

10. Public Utilities Regulatory Policies Act of 1978 § 201(17)(A)(ii), 16 U.S.C. § 796(17)(A)(ii) (2000).

11. Federal Power Act § 3(17)(E), 16 U.S.C. § 796(17)(E) (2000) (stating an “eligible solar, wind, waste or geothermal facility” means a facility which produces electric energy solely by the use, as a primary

The Commission's regulations defined a "cogeneration facility" as "equipment used to produce electric energy and forms of useful thermal energy (such as heat or steam), used for industrial, commercial, heating, or cooling purposes, through the sequential use of energy" ¹² The FERC's regulations defined "useful thermal energy output" as thermal energy that is made available to an industrial or commercial process; used in a heating application (e.g., space heating, domestic hot water heating); or used in a space cooling application (i.e., thermal energy used by an absorption chiller). ¹³ The Commission had employed a "presumptively useful" test for common industrial or commercial applications in cases interpreting the useful thermal output requirement. If the use of a cogeneration facility's thermal output constituted a common industrial or commercial application, it was presumed to be useful and the Commission did not inquire further into how the product produced by the thermal output would be used (i.e., the FERC did not examine the economics of the application). ¹⁴ The presumption of usefulness was not rebuttable. ¹⁵

If, on the other hand, the thermal use involved a technology that was novel or had not previously been found to be economically justified, the FERC applied one of two standards, depending on whether the thermal output would have been used by an affiliate of the cogenerator or by an unaffiliated entity. In the case of an unaffiliated thermal host, plausible evidence of either an arm's-length market for the thermal output or an end product produced with the aid of the thermal output was *prima facie* evidence of usefulness. ¹⁶ This evidence may have included quantitative data, statements of potential purchasers, or other evidence that a market was available. ¹⁷ In the case of an affiliated thermal host (or the cogenerator itself), the FERC required evidence that the thermal output was economically justified in an independent business setting (e.g., that the thermal use was economical absent the incentive to qualify for QF status and, therefore, independent of the intent to produce power). ¹⁸ A cost-benefit analysis of the thermal use provided such evidence. ¹⁹

Further, the Commission's efficiency requirements for qualifying cogeneration facilities distinguished between two types of cogeneration facilities; "topping-cycle" facilities, in which "the energy input to the facility is first used to produce useful power output, and at least some of the reject heat from the power production process is then used to provide useful thermal

energy source, of solar energy, wind energy, waste resources or geothermal resources . . . "; submitted either an application for QF certification or notice of self-certification "to the Commission not later than December 31, 1994"; and commenced construction of such facility not later than December 31, 1999).

12. 18 C.F.R. § 292.202(c) (2005).

13. 18 C.F.R. § 292.202(h) (2005).

14. *Panda-Rosemary Ltd. P'ship*, 100 F.E.R.C. ¶ 61,189 at P 10 (2002); *Electrodyne Research Corp.*, 32 F.E.R.C. ¶ 61,102 (1985).

15. *Brazos Elec. Power Coop.*, 83 F.E.R.C. ¶ 61,176, at p. 61,727 (1998) (citing *Bayside Cogeneration, L.P.*, 67 F.E.R.C. ¶ 61,290, at p. 62,006 & n.4 (1994)), *reh'g denied*, 85 F.E.R.C. ¶ 61,097 (1998), *petition for review denied sub nom.*, *Brazos Elec. Power Coop., Inc. v. FERC*, 205 F.3d 235 (5th Cir. 2000), *reh'g en banc denied*, 214 F.3d 1352 (5th Cir. 2000), *cert. denied*, 531 U.S. 957 (2000).

16. 32 F.E.R.C. ¶ 61,102, at p. 61,279, as clarified in *LaJet Energy Co.*, 43 F.E.R.C. ¶ 61,288, at p. 61,789 (1988), *reh'g denied*, 44 F.E.R.C. ¶ 61,070 (1988); *Wilbur Power LLC*, 103 F.E.R.C. ¶ 61,183 (2003), *clarified*, 104 F.E.R.C. ¶ 61,055 (2003).

17. 32 F.E.R.C. ¶ 61,102, at p. 61,279.

18. *Id.* at p. 61,278.

19. *Electrodyne Research Corp.*, 32 F.E.R.C. ¶ 61,102, at p. 61,278 (1985).

energy;”²⁰ and “bottoming-cycle” facilities, in which “the energy input to the system is first applied to a useful thermal energy application or process, and at least some of the reject heat emerging from the application or process is then used for power production”²¹

A topping-cycle cogeneration facility qualified as a QF if, in addition to satisfying the QF ownership criteria, it had a useful thermal output of no less than 5% of the total energy output of the facility (referred to as the operating standard)²² and, if it was a natural gas or oil-fired facility installed on or after March 13, 1980, the facility satisfied a minimum efficiency standard.²³ Both the operating and efficiency values were calculated on a calendar year basis, beginning with the calendar year following the date the facility first produced electricity. The operating and efficiency standards also had to have been satisfied for the initial twelve-month period beginning with the date electricity was first produced.²⁴ Bottoming-cycle facilities were not subject to the operating or efficiency standard. There were no size limitations applicable to qualifying cogeneration facilities.

Ownership Limitations. Section 201 of PURPA stated that a QF must be “owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities)”²⁵ While, as noted, there were two categories of QFs under PURPA—qualifying cogeneration facilities and qualifying small power production facilities—the ownership requirements applicable to each were identical under PURPA and the Commission’s regulations, as well as under Commission precedent.

The first part of the Commission’s QF utility ownership rules mirrored the statutory language and stated that a cogeneration or small power production facility “may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities)”²⁶ The second part of the Commission’s QF ownership rules, which served to interpret the first part, stated that

[f]or purposes of this section, a cogeneration or small power production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof.²⁷

This rule further provided that “[i]f a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a

20. 18 C.F.R. § 292.202(d) (2005).

21. 18 C.F.R. § 292.202(e) (2005).

22. 18 C.F.R. § 292.205(a)(1) (2005).

23. 18 C.F.R. § 292.205(a)(2) (2005). Specifically, the efficiency standard required that the useful power output of the facility plus one-half the useful thermal energy output must be no less than 42.5% of the total energy input of natural gas or oil. *Id.* However, if the ratio of the useful thermal energy output to the total energy output of the facility (i.e., the operating value) was less than 15%, the useful power output of the facility plus one-half of the useful thermal energy output must have been no less than 45%. 18 C.F.R. § 292.205(a)(2).

24. *Id.*

25. Public Utilities Regulatory Policies Act of 1978 §§ 201(17)(C)(ii), 201(18)(B)(ii), 16 U.S.C. §§ 796(17)(C)(ii), 796(18)(B)(ii) (2000).

26. 18 C.F.R. § 292.206(a) (2005).

27. 18 C.F.R. § 292.206(b) (2005).

facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or electric utility holding company."²⁸ Put simply, the Commission's PURPA utility ownership rules employed an upstream test to identify the equity interests in a QF held by an electric utility or an electric utility holding company and limited the equity interests that these entities cumulatively held to no more than 50%.²⁹

The ownership of foreign utility companies or power marketers did not cause a company owning a QF to be considered an electric utility or holding company for QF ownership purposes. For example, in *General Electric Capital Corp.*, the Commission ruled that ownership of foreign electric facilities had no effect on whether a QF satisfied the Commission's ownership criteria,³⁰ and, in *Brooklyn Navy Yard Cogeneration Partners, L.P.*, the Commission found that the owner of a QF was not considered an electric utility or holding company by reason of its ownership of a power marketer.³¹ Similarly, a QF owner may own or may itself be an exempt wholesale generator (EWG), as defined in the Public Utility Holding Company Act of 1935 (PUHCA) as amended,³² without violating QF ownership rules.³³

In order to determine what constituted an equity interest for purposes of the QF ownership requirements, the Commission's PURPA regulations equated "ownership interest" with "equity interest," but did not define the term "equity interest."³⁴ The Commission, in *Indek North American Power Fund, L.P.*, observed that "[t]his definitional issue has been most problematic in cases involving partnerships as opposed to corporations. This is because the stated percentage of partnership interests in partnership agreements does not always correspond with specific provisions in the partnership agreements concerning control of and/or division of benefits from the partnership assets."³⁵ As a result, the Commission examined "the entitlement to . . . profits, losses, and surplus after return of initial capital contribution[s] [the "stream of benefits"], as well as the . . . share . . . [of] control of the venture[,]"³⁶ to determine "whether the division of equity interests in a partnership complie[d] with the statutory and

28. *Id.*

29. The Commission's PURPA regulations adopt the definition of "electric utility" found in Section 3(22) of the FPA, which defines an electric utility as "any person, State agency, or Federal agency, which sells electric energy." 16 U.S.C. § 2602(4) (2000); see *Long Lake Energy Corp.*, 51 F.E.R.C. ¶ 61,262, at p. 61,770 (1990). The Commission's PURPA regulations define "electric utility holding company" as "a holding company, as defined in section 2(a)(7) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79b(a)(7) which owns one or more electric utilities, as defined in section 2(a)(3) of that Act, 15 U.S.C. [sic] 79b(a)(3), but does not include any holding company which is exempt by rule or order adopted or issued pursuant to sections 3(a)(3) or 3(a)(5) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79c(a)(3) or 79c(a)(5)." 18 C.F.R. § 292.202(n) (2005). The section 3(a)(3) exemption, generally speaking, is applicable to holding companies that are "only incidentally" holding companies, while the section 3(a)(5) exemption is generally referred to as the "foreign holding company" exemption. 15 U.S.C. §§ 79c(a)(3), 79c(a)(5) (2000).

30. *Gen. Elec. Capital Corp.*, 70 F.E.R.C. ¶ 61,141 (1995).

31. *Brooklyn Navy Yard Cogeneration Partners, L.P.*, 74 F.E.R.C. ¶ 61,015 (1996).

32. A EWG was the owner of an "eligible facility," i.e., an electric generating plant used solely to produce electricity sold in the wholesale market. 15 U.S.C. § 79z-5a(a) (2000). PUHCA was repealed by EPAAct 2005. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1263, 119 Stat. at 974.

33. See, e.g., *Vineland Cogeneration Ltd. P'ship*, 99 F.E.R.C. ¶ 61,304, at p. 62,272 n.14 (2002).

34. See *Ultrapower 3*, 27 F.E.R.C. ¶ 61,094, at p. 61,183 (1984).

35. *Indeck N. Am. Power Fund, L.P.*, 85 F.E.R.C. ¶ 61,239, at pp. 62,001-02 (1998).

36. 27 F.E.R.C. ¶ 61,094, at p. 61,184.

regulatory ownership requirements for QF status.”³⁷ The two-pronged test established in these orders formed the basis for all subsequent FERC orders on the permissible scope of utility ownership of QFs under PURPA.

2. Mandatory Purchase Requirement

PURPA created a market for the power generated by QFs by requiring electric utilities to purchase energy generated by QFs and by instructing the FERC to promulgate rules to ensure that the rates for such purchases are just and reasonable and do not discriminate against QFs.³⁸ PURPA specified that the rates paid for QF power must not exceed the incremental cost to the electric utility of alternative electric energy, commonly referred to as the utility’s avoided cost.³⁹ To encourage the development of QFs, the FERC opted to set PURPA rates at the maximum level allowed by the Act. The FERC’s regulations state that a just, reasonable, and nondiscriminatory rate for QF power is the avoided costs, which are to be determined after consideration of factors set out in the regulations.⁴⁰

3. Regulatory Exemptions

To further encourage the development of QFs, section 210(e) of PURPA required the FERC to exempt QFs from the FPA, PUHCA, and state utility regulation if the Commission determined that the exemption was necessary to encourage cogeneration and small power production.⁴¹ The Commission first implemented this requirement in Order No. 69, which promulgated regulations that exempted all QF cogeneration facilities and all QF small power production facilities with a nominal capacity of less than thirty megawatts (eighty megawatts in the case of geothermal facilities) from various sections of the FPA.⁴² The Commission has traditionally interpreted these exemptions broadly. For instance, the FERC found that the rates of exempt QFs were not subject to Commission review under section 205 of the FPA, nor did exempt QFs need Commission authority to make market-based rate sales.⁴³ Other important aspects of this provision included the exemption from the requirement that the Commission authorize dispositions of QFs’ jurisdictional facilities under section 203 of the FPA, exemption from the securities regulations set out by PUHCA

37. 85 F.E.R.C. ¶ 61,239, at pp. 62,001–02 (footnote omitted); *KP Diversified Investors, Inc.*, 32 F.E.R.C. ¶ 61,013, at p. 61,050 (1985).

38. Public Utilities Regulatory Policies Act of 1978, Pub. L. No. 95-617, § 210(a), (b), 92 Stat. 3117 (codified at 16 U.S.C. § 824a-3(a), (b) (2000)).

39. Public Utilities Regulatory Policies Act § 210(b) (codified at 16 U.S.C. § 824a-3(b) (2000)).

40. 18 C.F.R. § 292.304(b)(2) (2005).

41. Public Utilities Regulatory Policies Act § 210(e)(1) (codified at 16 U.S.C. § 824a-3(e)(1) (2000)).

42. 18 C.F.R. § 292.601 (2005) (exempting QFs from sections 203, 204, 205, 206, 208, 301, 302, and 304 of the FPA); see also Order No. 69, *Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, F.E.R.C. STATS. & REGS. ¶ 30,128, at p. 30,895 (1980), 45 Fed. Reg. 12,214 (1980) [hereinafter Order No. 69].

43. See *Pine Bluff Energy LLC*, 104 F.E.R.C. ¶ 61,227 (2003) (dismissing filing proposing rates for reactive power filed by QF on the ground that because its rates were exempt from section 205 of the FPA, its rates were also not subject to Commission review under that section), *reh’g denied*, 105 F.E.R.C. ¶ 61,152 (2003); *SP Newsprint Co.*, 103 F.E.R.C. ¶ 61,186 (2003) (dismissing application for market-based rate authority filed by QF because, as a QF exempt from section 205 of the FPA, no Commission authority was required for the QF to make market-based rate sales).

and exemption from state regulation of retail power sales.⁴⁴

B. Push for PURPA Reform

Opposition to PURPA, especially the Act's mandatory purchase requirement, has been mounting since PURPA's enactment and the promulgation of the FERC's implementing regulations nearly thirty years ago.⁴⁵ In the last decade, the most prominent criticism of PURPA's mandatory purchase requirement has been that it is anticompetitive.⁴⁶ Critics have argued, for example, that "the PURPA-based market excludes potential low-cost generators and imposes needless costs on much of the capacity that can be offered."⁴⁷ Others contend that PURPA's mandatory purchase requirement is outdated given the current movement towards competitive wholesale markets for electric power supplies.⁴⁸

Opponents of PURPA also criticized the Act and implementing regulations for not sufficiently encouraging the development of renewable resources.⁴⁹ Even the Commission has observed that QF projects were sometimes designed to take advantage of the competitive benefits conferred by PURPA without providing thermal and electrical energy primarily for a legitimate industrial or commercial purpose.⁵⁰ According to the Commission, there has "long been concern" that the "irrebuttable 'presumptively useful'" standard has allowed some cogeneration facilities to qualify under PURPA without serving an actual need for such facilities' thermal output (i.e., a "sham" use of the cogeneration facilities' thermal output).⁵¹ Moreover, the FERC cited concerns over so-called "PURPA machines"—facilities intended to produce electric power for sale to a utility and not primarily to serve the thermal or electrical needs of the facility's host.⁵²

III. THE PURPA AMENDMENTS OF 2005

EPAAct 2005 includes significant amendments to PURPA. These

44. 18 C.F.R. § 292.601 (2005).

45. See *Am. Paper Inst., Inc. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402 (1983) (industry challenged the FERC's avoided cost requirement, asserting its promulgation was arbitrary, capricious, and an abuse of the agency's discretion); *FERC v. Mississippi*, 456 U.S. 742 (1982) (Mississippi challenged the validity of PURPA as a legitimate exercise of congressional power under the Commerce Clause).

46. See Cudahy, *supra* note 5, at 423 (discussing the call for PURPA reform).

47. William W. Berry, *Competition in the Electric Industry: The Influence of PURPA, PUHCA, and Transmission Access*, 6 FALL NAT. RESOURCES & ENV'T 32, 33 (1991).

48. See AMY ABEL, CONGRESSIONAL RESEARCH SERVICE, CRS REPORT FOR CONGRESS, ELECTRIC UTILITY REGULATORY REFORM: ISSUES FOR THE 109TH CONGRESS CRS-12 (2005), available at <http://www.cnire.org/NLE/CRSreports/05aug/RL32728.pdf>; *National Electricity Policy: Barriers to Competitive Generation: Hearing Before the Subcomm. on Energy and Air Quality of the House Comm. on Energy and Commerce*, 107th Cong. 1-2 (2001) (statement of Bruce Levy, Senior Vice President and Chief Financial Officer, GPU, Inc.), available at <http://energycommerce.house.gov/107/Hearings/07272001hearing340/Levy551print.htm> [hereinafter Levy Statement].

49. See Levy Statement, *supra* note 48, at 6 (citing statistics that non-renewable sources of energy still make up more than 75% of all installed non-utility generating capacity). But see Cudahy, *supra* note 5, at 422 (arguing that PURPA has succeeded in increasing the number of non-traditional new generating projects).

50. See Notice of Proposed Rulemaking, *Revised Regulations Governing Small Power Production and Cogeneration Facilities*, F.E.R.C. STATS. & REGS. ¶ 32,590 at P 13, 70 Fed. Reg. 60,456 (2005) [hereinafter QF NOPR].

51. *Id.* at P 7.

52. QF NOPR, *supra* note 50, at P 10.

amendments (the PURPA Amendments) modify the criteria for QF status and repeal the mandatory purchase requirements for utilities operating in competitive markets.⁵³ To implement portions of the PURPA Amendments, the Commission issued a notice of proposed rulemaking in October 2005 and a final rule in February 2006 addressing changes in QF qualifying requirements and QF exemptions from federal regulation.⁵⁴

A. *Change in Qualifying Requirements*

1. Cogeneration Facilities

The PURPA Amendments require the FERC to revise the criteria for new qualifying cogeneration facilities to ensure that the thermal output of the facility “is used in a productive and beneficial manner;” that the “electrical, thermal, and chemical output of the cogeneration facility is used fundamentally for industrial, commercial, or institutional purposes and is not intended fundamentally for sale to an electric utility[;]” and that there is “continuing progress in the development of efficient electric energy generating technology.”⁵⁵ The Commission’s new QF regulations, which incorporate this statutory language without any further explication, require the Commission to determine on a case-by-case basis whether a new cogeneration facility qualifies for QF status.⁵⁶ The new regulations, however, retain the current practice of providing QFs with the option of self-certification.⁵⁷ While the Commission will not necessarily review each certification of QF status on a case-by-case basis to ensure compliance with the new regulations, the new regulations clarify that the Commission may revoke, on its own motion, the QF status of self-certified QFs.⁵⁸

Beneficial use. The Commission will no longer employ an irrebuttable “presumptively useful” standard in determining whether a new cogeneration facility’s thermal output is put to a productive use.⁵⁹ Instead, the Commission will consider the presumption of usefulness to be rebuttable and, further, will examine the use of a cogeneration facility’s thermal output to ensure that the output serves a legitimate purpose under the Act.⁶⁰

Fundamental use. Applications for certification of new facilities are required to include a detailed explanation of how the cogeneration facility meets the requirement that the fundamental use of a QF’s output is for industrial, commercial, or institutional purposes and not for the sale of electricity to an electric utility.⁶¹ The Commission created a safe harbor, within which a facility

53. See Energy Policy Act of 2005, Pub. L. No. 109-58, § 1253, 119 Stat. 594.

54. See QF NOPR, *supra* note 50; Order No. 671, *Revised Regulations Governing Small Power Production and Cogeneration Facilities*, F.E.R.C. STATS. & REGS. ¶ __ (2006), 71 Fed. Reg. 7852 (2006) (to be codified at 18 C.F.R. pts. 131 and 292) [hereinafter QF Rule].

55. Energy Policy Act of 2005 § 1253(a).

56. QF Rule, *supra* note 54, at P 22.

57. *Id.* at P 78.

58. QF Rule, *supra* note 54, at P 79.

59. *Id.* at P 17.

60. QF Rule, *supra* note 54, at P 17. However, the Commission will apply a rebuttable presumption that new cogeneration facilities that are 5 MW or smaller satisfy the productive and beneficial use requirement. *Id.* at P 26.

61. QF Rule, *supra* note 54, at P 28; QF NOPR, *supra* note 50, at P 12.

will be presumed to comply with the fundamental use requirement.⁶² To qualify under the safe harbor provisions, a new cogeneration facility seeking to sell its electrical output pursuant to section 210 of PURPA will be required to demonstrate that at least 50% of the aggregated annual energy output of the facility is to be used for industrial, commercial, residential or institutional purposes and not sold to an electric utility.⁶³ New cogeneration facilities that do not fall within the safe harbor provision must disclose in their applications the percentage of aggregated annual energy output that is used for industrial, commercial, residential or institutional purposes, along with discussion of and support for why the Commission should conclude that the fundamental use requirement is satisfied.⁶⁴

Efficiency progress. The new rules add verbatim to the Commission's regulations EPAAct 2005's requirement that the Commission ensure the "continuing progress in the development of efficient electric energy generating technology."⁶⁵ Applicants will not be required to submit any information under this requirement; rather, the Commission believes that the QF qualifying criteria regarding beneficial and fundamental uses is sufficient to ensure the efficiency requirement has been met.⁶⁶ The FERC also indicated that it would retain the existing operating and efficiency standards for new oil and gas cogeneration facilities and would not impose new efficiency standards for new coal-burning cogeneration facilities⁶⁷ at this time.⁶⁸

2. Ownership Criteria

The PURPA Amendments modify section 201 of PURPA to eliminate the limitations on utility ownership.⁶⁹ The Commission's new rules repeal section 292.206 of its regulations, and thus eliminate ownership limitations for new and existing QFs.⁷⁰ The Commission, however, will still require applicants for QF certification to provide ownership information on Form 556.⁷¹

B. FPA Exemptions

Though the PURPA Amendments do not address this issue, the Commission's new rules revise the broad exemptions from the FPA granted to QFs.⁷² The FERC concluded that not all of the exemptions from the FPA were still necessary to encourage the development of QFs and was concerned that the original exemptions removed a large number of generation sales from any regulatory oversight.⁷³ Thus, the Commission eliminated the exemptions from

62. QF Rule, *supra* note 54, at P 50.

63. *Id.* at P 51.

64. QF Rule, *supra* note 54, at P 51. However, the Commission will apply a rebuttable presumption that new cogeneration facilities that are 5 MW or smaller satisfy the fundamental use requirement. *Id.* at P 60.

65. QF Rule, *supra* note 54, at P 68.

66. *Id.*

67. QF Rule, *supra* note 54, at P 16.

68. *Id.* at P 69.

69. Energy Policy Act of 2005, Pub. L. No.109-58, § 1253(b), 119 Stat. 594.

70. QF Rule, *supra* note 54, at PP 104, 107.

71. *Id.* at P 110.

72. QF Rule, *supra* note 54, at P 92.

73. *Id.* at P 96.

sections 205 and 206 of the FPA for sales not made pursuant to a state regulatory authority's implementation of PURPA.⁷⁴ Moreover, any facility of 20 MW or less would remain exempt from sections 205 and 206 of the FPA, regardless of the type of sales made.⁷⁵ The Commission's new rules also state that QFs are subject to the new provisions of the FPA added in EPAct 2005 regarding market transparency, false statements, and market manipulation.⁷⁶

C. *Removal of Mandatory Purchase Requirement*

The PURPA Amendments repeal, in certain circumstances, the requirement of section 210 of PURPA that electric utilities purchase the electric energy output from QFs.⁷⁷ Specifically, utilities will not be required to enter into power purchase agreements with QFs if the Commission finds that the QF has nondiscriminatory access to wholesale markets for both short-term and long-term sales of energy and capacity that are administered independently or by a Commission-approved regional transmission entity pursuant to an open access transmission tariff.⁷⁸ A utility may file a petition with the Commission for relief from the mandatory purchase requirement, and the Commission is required to act on such petition within ninety days of its filing.⁷⁹ The Commission has rejected one such petition on procedural grounds⁸⁰ and has commenced a separate rulemaking to implement the requirements in the new PURPA Section 210(m).⁸¹

IV. ANALYSIS

The PURPA Amendments will change the regulatory landscape for cogeneration facilities and small power production facilities. It is impossible to know the extent of these changes, especially at this early stage, but some implications can be surmised from an examination of the PURPA Amendments, the FERC rulemaking, and the industry itself.

A. *Impact of Alterations to Cogeneration Facility Qualifying Requirements*

The sharpened focus on the uses of the output of cogeneration facilities will likely change the design of new facilities. The requirement for a beneficial use for the facilities' thermal output and a primarily commercial or industrial use for the electrical, mechanical, and chemical output will present new obstacles to cogeneration facility development and undoubtedly render some potential new cogeneration projects no longer viable.

Exactly how significant these impacts will be to the industry will depend on the Commission's method of applying the revised statutory criteria for QF status

74. QF Rule, *supra* note 54, at P 92. The Commission notes that "many sales made pursuant to bilateral contracts between QFs and electric utilities (including contracts at market-based rates) are made pursuant to a state regulatory authority's implementation of PURPA." *Id.* at P 99.

75. QF Rule, *supra* note 54, at P 96.

76. *Id.* at P 103.

77. Energy Policy Act of 2005, Pub. L. No. 109-58, § 1253(a), 119 Stat. 594.

78. *Id.*

79. Energy Policy Act of 2005 § 1253(a).

80. *Alliant Energy Corporate Servs., Inc.*, 113 F.E.R.C. ¶ 61,024 (2005).

81. See Notice of Proposed Rulemaking, *New PURPA Section 210(m) Regulations Applicable to Small Power Production and Cogeneration Facilities*, F.E.R.C. Stats. & Regs. ¶ 32,597, 71 Fed. Reg. 4532 (2006) [hereinafter Mandatory Purchase NOPR].

to new applications. This development, especially when paired with the elimination of the “presumptively useful” standard for thermal output, will dramatically heighten regulatory uncertainty as to the eligibility of new facilities for QF status. One commenter on the proposed changes stated that a case-by-case determination of qualifying status without the benefit of a clear standard (such as “presumptively useful”) will inject uncertainty into QF development and make financing new cogeneration facilities difficult, “if not infeasible.”⁸²

Indeed, the change from the current standards for certification to a more subjective determination will itself alter a basic principle of the prior PURPA regime. Previously, a facility that met the requirements for QF status was deemed to be a QF regardless of whether it had filed to obtain such status. This indifference to certification status has been reversed under the new QF rules in which the Commission specifies that the owner or operator of a facility claiming QF status must file either a notice of self-certification or an application for certification that contains a completed Form 556.⁸³

Additionally, although the PURPA Amendments and the new rules state that they only apply to “new” cogeneration facilities, it is not clear whether “new” means only cogeneration facilities constructed after the enactment of EAct 2005. Although it is unlikely that Congress intended such an interpretation, it is possible some may argue that changes to existing cogeneration facilities that require recertification of qualifying status also would render those facilities “new” for purposes of the PURPA Amendments and the implementing regulations. While the Commission stated in issuing the new QF regulations that there will be a rebuttable presumption that an existing QF does not become a “new cogeneration facility” under the PURPA Amendments merely because it files for recertification, the Commission also stated that changes to an existing cogeneration facility could be so great that “what an applicant is claiming to be an existing facility should, in fact, be considered a ‘new’ cogeneration facility at the same site.”⁸⁴ This could affect a QF owner’s willingness to make needed or beneficial changes, and could interfere with refinancing or selling existing QFs by creating uncertainty as to the future regulatory status of the facilities.

B. Repeal of the Ownership Limitation

Prior to the PURPA Amendments, the limitation on utility ownership of QFs influenced both the development of and investment in QFs. Removal of this limitation will open the door to increased utility investments in QFs, and broaden the prospects for financing development of new facilities and investment in existing facilities. This increased investment may be particularly prevalent in retail markets, where QFs will remain exempt from most state regulation. However, the impact of the repeal of the ownership limitation, especially in wholesale markets, may be tempered by the possible removal of the exemption

82. Motion to Intervene and Comments of Indeck Energy Services, Inc., FERC Docket No. RM05-36-000, at 4 (Nov. 8, 2005); *see also* Comments of Cogentrix Energy Inc. & the Goldman Sachs Group Inc. on Notice of Proposed Rulemaking, FERC Docket No. RM05-36-000, at 14 (Nov. 8, 2005) (stating that removal of the presumptively useful standard would remove the “regulatory certainty that is critical to entities that invest in cogeneration facilities”).

83. QF Rule, *supra* note 54, at P 81.

84. *Id.* at P 115.

from various federal regulations. As discussed below, these exemptions have been strong motivations for wholesale power generators to obtain QF status.

C. *Removal of the Mandatory Purchase Requirement*

The effect of the repeal of PURPA's requirement, under certain circumstances, that utilities must purchase the output of QFs is difficult to predict for a variety of reasons. First, reliance on this requirement has decreased significantly in recent years because administrative determinations of avoided cost have been replaced by bidding and other market-driven concepts in establishing the rates under QF power purchase agreements. Furthermore, even to the extent administrative determinations of avoided cost remain available, states have moved away from one of the primary benefits of this type of rate design, which was the "front-end loaded" rate structure wherein QFs would recover a disproportionate share of its costs in the early years of the power purchase contract. Second, the scope of the repeal will not be known until the Commission completes the rulemaking commenced by the issuance of the Mandatory Purchase NOPR. However, the Commission's proposal in the Mandatory Purchase NOPR to make a preliminary finding that all QFs interconnected with utilities that are members of the Midwest Independent Transmission System Operator, Inc. (Midwest ISO), PJM Interconnection, L.L.C. (PJM), ISO New England, Inc. (ISO-NE) or New York Independent System Operator (NYISO) satisfy the statutory requirements for removing the mandatory purchase obligation indicates the potential for sweeping application of the repeal.⁸⁵ If this proposal is adopted in its current form, QFs in many parts of the country will no longer have the benefit of the mandatory purchase requirement with respect to any "new contract or obligation."⁸⁶

The uncertainty of the ongoing developments related to the elimination of the mandatory purchase requirement is itself likely to have some impact on QFs—and especially those that were under development upon enactment of EPAct 2005. As utilities attempt to withdraw from negotiations to purchase power from these facilities, the developers of the facilities may face hurdles in maintaining financing, meeting construction deadlines, and even possibly executing power purchase, site, and off-take agreements with new (non-utility) purchasers.

D. *Loss of Regulatory Exemptions*

The removal of some of the exemptions most QFs now enjoy from federal utility-type regulation, including the exemption from rate regulation under sections 205 and 206 of the FPA, has the potential to dramatically affect the QF industry. The Commission's decision to subject all "non-PURPA" sales (i.e., sales of QF output not made pursuant to a state regulation authority's implementation of PURPA) could affect a large number of sales, as PURPA sales have decreased in recent years due to the rise of competitive bidding and other market-related forces. Indeed, the scope of the repeal of these exemptions is not entirely clear under the language of the QF Rule, which does not establish a bright line for determining whether a QF contract was made "pursuant to a

85. See Mandatory Purchase NOPR, *supra* note 81, at P 12.

86. Energy Policy Act of 2005, Pub. L. No. 109-58, § 1253(a), 119 Stat. 594.

state regulatory authority's implementation of PURPA."⁸⁷ This uncertainty is potentially disruptive to the billions of dollars invested in QFs based on contracts exempt from Commission rate regulation.

To the extent that existing QF contracts become subject to the FERC ratemaking jurisdiction under the FPA, challenges to those contracts, under either the "just and reasonable" standard of FPA sections 205 and 206, or even the *Mobile-Sierra* standard,⁸⁸ could mean extensive litigation affecting millions of dollars of revenues, including potentially large refunds. Modifications of such contracts would create a myriad of complications for QFs and their lenders and investors, who typically have relied on power sale agreements to support QF financings and the ongoing viability of QF facilities.⁸⁹ On the most general level, the requirement to justify rates for power sold by QFs has the potential to call the continuing value of QF status itself into question, at least in the realm of wholesale power sales. According to commenters on this proposal,

FPA rate regulation of existing QF[s] . . . will upset long-settled expectations based on PURPA and the Commission's existing rules and regulations, will create unnecessary and disruptive uncertainty regarding the financial integrity of numerous existing QFs, and change the risk profile for all QFs subject to FPA rate regulation

E. Continuing Relevance of PURPA as a Regulatory Regime

The scope of the changes to PURPA, when considered in the aggregate, may ultimately result in a significant reduction in the scope and importance of PURPA's regulatory regime, especially as it applies to the wholesale market. This is likely for several reasons. First, the number of new cogeneration facilities that will qualify under the more rigid output requirements is likely to decrease. Second, the potential (though perhaps unlikely) application of these new standards to facilities existing before the enactment of EPAct 2005, but requiring recertification after the new rules take effect, will impact how many facilities are governed by the Act. Also affecting the continued relevance of PURPA as a regulatory regime will be the reduced benefits that qualifying status would bring, including the loss of the exemptions from rate regulation under the FPA for sales made outside the context of a state regulatory authority's implementation of PURPA. These "PURPA sales" themselves may become increasingly rare as the benefit of the mandatory purchase requirement is repealed for QFs that sell power into markets that the FERC has determined to

87. The distinction between contracts entered into under a state regime and those entered into under other circumstances is not self-evident. For example: QF and utility purchasers sometimes negotiate modifications of state-approved standard offer contracts; utilities in some states have conducted competitive procurements under state avoided cost regimes; and some states' only "approval" is an order allowing utilities to recover costs paid for QF power. See Comments of Constellation Energy Group, Inc., FERC Docket No. RM05-36-000, at 8-9 (Nov. 8, 2005); see also Comments of Public Service Electric & Gas Co. PSEG Power LLC, PSEG Energy Resources & Trade LLC & PSEG Global L.L.C., FERC Docket No. RM05-36-000, at 3-4 (Nov. 8, 2005).

88. *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (contract under the NGA); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (contract under the FPA).

89. See, e.g., Initial Comments of CE Generation, LLC on Proposed Amendments to FERC Rules Governing Qualifying Facilities Under PURPA, FERC Docket No. RM05-36-000, at 8-9 (Oct. 8, 2005).

90. Comments of the Electric Power Supply Ass'n on Proposed Revisions to Regulations Governing Small Power Production & Cogeneration Facilities, FERC Docket No. RM05-36-000, at 3 (Nov. 8, 2005).

be competitive under the PURPA Amendments.

The declining importance of QFs in the wholesale market may be counterbalanced somewhat by an increasingly important role for QFs in the retail market. Given the elimination of the restriction on utility ownership, QFs may become an attractive way for utilities or their unregulated affiliates to compete with marketers for retail loads. This appeal of QFs in retail markets may be reinforced by retention of the QF exemption from state regulation. Although the elimination of key FPA exemptions mean that QFs may be regulated at the federal level much more like all other generators with respect to both rates and sales of facilities, QFs will be able to make sales of power at retail without being subject to state utility regulation.

Thus, it appears that the reach of PURPA—in terms of both facilities governed and benefits conferred—will diminish once implementation of the revised statute is completed. Although this diminished reach may be tempered by increased interest in investment in QFs producing power to sell in retail markets, on the whole it is likely PURPA's ongoing impact on the electricity industry will diminish as well.

V. CONCLUSION

EPAct 2005 initiated significant changes to the extent and nature of the PURPA's regulation of cogeneration and small power production facilities. The PURPA Amendments and the implementing regulations promulgated by the FERC will change the types of facilities that qualify for the incentives and benefits offered under the Act and will also change the nature of the incentives and benefits themselves. As a result, the PURPA Amendments and the implementing regulations will affect the development of new cogeneration facilities and at least to some extent alter the regulatory framework under which existing QFs operate. The precise effects these changes will have on the QF industry will depend on several factors, including economic conditions, competitive power prices, and other factors not directly related to legislation or regulation. However, it is clear that a new era of PURPA regulation has begun: one in which PURPA is likely to be less powerful and less relevant than before.