NOTE

ENFORCING ENERGY EFFICIENCY STANDARDS
AFTER INDEPENDENT ENERGY PRODUCERS
ASS'N v. CALIFORNIA PUBLIC UTILITIES
COMMISSION

I. Introduction

In 1978, Congress enacted the Public Utility Regulatory Policies Act (PURPA) in response to rapidly fluctuating conditions in the energy market. PURPA was intended to promote alternative fuel use and cogeneration in an effort to reduce dependence on foreign petroleum. PURPA empowers the Federal Energy Regulatory Commission (FERC) to establish regulations to achieve these goals. For some time after the statute's enactment, many states claimed that it violated the Tenth Amendment because it gives the FERC ultimate authority to regulate certain aspects of the traditionally state-regulated utility industry. The Supreme Court nevertheless held the statute constitutional in *FERC v. Mississippi*. More recently, however, controversies have arisen involving state implementation of FERC regulations created under PURPA. One of the most significant cases in this regard is *Independent Energy Producers Ass'n v. California Public Utility Commission* (*IEP*), wherein several cogeneration facilities challenged the California Public Utility Commission's (CPUC) PURPA implementation program (CPUC program), claiming the program conflicts with PURPA.

In *IEP*, the United States Court of Appeals for the Ninth Circuit examined the CPUC's PURPA implementation program, which allowed utilities to enforce Qualified Cogeneration Facilities' (QFs) compliance

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4. PURPA gives the FERC exclusive power to enact regulations enumerating the criteria for qualifying cogeneration facilities. The FERC determines whether a cogeneration facility reaches the status of a "Qualifying Facility," thereby earning a qualified exemption from the Public Utility Holding Company Act and certain state rate regulations. See 16 U.S.C. §§ 796, 824a-3 (1994).
5. 456 U.S. 742.
7. 36 F.3d 848 (9th Cir. 1994)
8. Id.
with FERC efficiency standards. If a QF failed to meet FERC standards, the program authorized the utility to sanction the QF by suspending contractual payments or by substituting lower, “alternative rates.”

Independent Energy Producers Association (Energy Producers) argued that the utility’s evaluation and alteration of rates amounted to a QF status determination, and that such status determinations are reserved to the FERC under PURPA. The Ninth Circuit agreed with Energy Producers and ruled that the CPUC implementation program was preempted by PURPA “insofar as it authorizes the Utilities to determine that a QF is not in compliance with the Commission’s operating and efficiency standards.”

This Note explores whether the Ninth Circuit’s analysis of the CPUC program is inconsistent with PURPA’s intent to provide states with autonomy to implement PURPA. Secondly, imposing sanctions upon QFs is different than making QF status determinations; the CPUC program sanctions merely enforced the regulations created by the FERC under PURPA.

The flaw in the CPUC program was that it authorized utilities to substitute the lower, “alternative rate” for the contractual rate originally approved by the CPUC. This type of unilateral contract alteration exposes a QF to utility-type regulation and is preempted by PURPA.

Two recent decisions, Freehold Cogeneration Assocs. v. Board of Regulatory Commissioners of New Jersey (Freehold Cogeneration) and Smith Cogeneration, Inc. v. Corporation Commission (Smith Cogeneration), provide guidance to state PUCs regarding contract alteration where IEP does not. Smith Cogeneration and Freehold Cogeneration indicate that state PUCs and utilities may sanction QFs for inefficiency. However, Power Purchase Agreements (PPAs) between QFs and utilities may be altered by a state PUC prior to its approval by the PUC. Further, PPAs may contain sanction provisions for QF noncompliance.

Part II of this Note provides a general overview of PURPA and the Supreme Court’s interpretation of the statute in FERC v. Mississippi. Part III sets out the Ninth Circuit’s reasoning in IEP. Part IV analyzes the

9. Id. at 850.
10. Id. at 859. The court did not, however, preempt the entire program, stating: [I]nsofar as the CPUC’s program requires QFs to submit operating data to the Utilities for monitoring, and insofar as the monitoring requirements do not impose an undue burden on the QFs, the program is not preempted. Because reasonable monitoring by the state and by utilities does not by itself effect a determination of status, it falls within the state’s broad ratemaking authority.

Id.
13. 44 F.3d 1178 (3d Cir. 1995).
15. See discussion infra part IV. B.
proposition that states may create sanctions for QF non-compliance in the form of alternative rates under the broad ratemaking power delegated to the states under PURPA. Part V concludes that the Ninth Circuit's decision in IEP limits the states' ability to implement PURPA effectively.

II. BACKGROUND
A. The Public Utility Regulatory Policies Act of 1978

Fossil fuel conservation reached Congress's agenda under the veil of the Arab oil embargo of 1973. Since then, Congress has decreased domestic dependence on foreign fossil fuels by, among other things, emphasizing the use of alternative fuel sources and renewable resources. These alternative sources—wind, solar, hydro, and geothermal—are often employed by "small power producers" or cogenerators who use little, if any, fossil fuel to generate electricity. In order to reduce dependence on foreign fossil fuels, Congress, through PURPA, encouraged the development of alternative power generators and the use of renewable resources.

Prior to PURPA's enactment, cogenerators and small power producers faced a number of obstacles. To avoid the economic burdens of government regulation, cogenerators and small power producers look to market the power they generate to public utilities, rather than the public. Electric utilities, which are heavily regulated by state and federal agencies, were often reluctant to purchase power from these unregulated entities—some utilities even viewed these power producers as competitors in the energy market. Many utilities who did purchase power from cogenerators or


18. See Martin, supra note 3, at Id. In 1980, electric utilities used 5.3 trillion kilowatt-hours (kwh) of energy derived from fossil fuels. It is estimated that energy consumption by electric utilities could exceed from 8.4 to 17.7 trillion kwh by the year 2000. Id. See Robert G. Uhler and Benjamin Zycher, Energy Forecasting and Its Uncertainties, 105 PUB. UTILS. FORUM 27, 28-30, Jan. 17, 1980.

19. A "small power production facility" is a facility which produces electric energy using either biomass, waste products, renewable resources or any combination thereof as the primary energy source, without exceeding a maximum production capacity of 80 megawatts. 16 U.S.C. § 796(17)(A)(i)-(ii) (1994).

20. Plymouth Rock Energy Assocs. v. Department of Pub. Utils., 648 N.E.2d 752 (Mass. 1995). Of course, PURPA's goals were broader than enhancing reliance on alternative fuels. PURPA was also intended to control power generation costs and ensure long-term economic growth by reducing the nation's reliance on oil and gas and increasing the use of more abundant domestically-produced fossil fuels. Freehold Cogeneration,44 F.3d at 1182. PURPA was Congress' response to rapidly fluctuating conditions in the energy market, and possible shortages of non-renewable energy. FERC v. Mississippi, 456 U.S. 742, 745 (1982). See also State of N.C. ex rel. Utils. Comm'n v. North Carolina Power Comm'n, 450 S.E.2d 896 (N.C. 1994).


Prior to PURPA, the world of electricity regulation was divided on the basis of whether the sale of electricity was retail or wholesale. States regulated retail transactions and the federal government regulated wholesale intrastate transactions. An electric utility usually engaged in both and was, therefore, subject to both state and federal rate regulation. Id. at 325.

22. Martin, supra note 3, at 150-151.
small power producers refused to pay a reasonable rate or charged unusually high rates for back-up service.\textsuperscript{23} In addition, cogenerators did not want to be considered “public utilities” and become subject to state and federal regulations while providing electricity to a utility.\textsuperscript{24} Congress, through PURPA, sought to eliminate these barriers to the development of alternative energy producers.\textsuperscript{25}

The Ninth Circuit in \textit{IEP} focused its analysis on Title II of PURPA,\textsuperscript{26} which provides that a cogenerator or small power facility must meet certain criteria to become a “qualifying facility” (QF).\textsuperscript{27} Title II criteria are established by the FERC and specify: the “primary energy source” allowable for an energy producer; the maximum generating output; restriction on ownership of the facility; and that the facility produce both electricity and another form of energy concurrently.\textsuperscript{28} Additionally, PURPA exempts QFs from certain federal and state regulations, and requires utilities to offer to purchase electric energy from the QFs at the utilities’ avoided cost\textsuperscript{29} or a negotiated rate.

PURPA empowers the FERC to establish standards and regulations that encourage the success of QFs and charges the states with the implementation of the FERC’s rules.\textsuperscript{30} FERC regulations promulgated under section 201 of PURPA provide three methods by which a PUC can implement PURPA provisions. First, the PUC can issue regulations pursuant to the FERC guideline.\textsuperscript{31} Second, the PUC can attempt to resolve disputes between utilities and QFs.\textsuperscript{32} Third, the PUC may take any other action reasonably designed to implement the FERC standards.\textsuperscript{33} Additionally,
the FERC has the power to force state regulatory agencies to comply with FERC regulations and PURPA.\textsuperscript{34}

Conflicts often arise under Title II of PURPA because it requires action from both state and federal agencies. Until the 1930s, utilities were regulated by state and local entities.\textsuperscript{35} PURPA expanded federal control of utilities considerably by imposing federal requirements upon state agencies.\textsuperscript{36} While many states implemented PURPA without objection, others challenged the constitutionality of PURPA, claiming that its effect was to usurp the states' power to regulate utilities.\textsuperscript{37} In \textit{FERC v. Mississippi},\textsuperscript{38} the Supreme Court confirmed the constitutionality of PURPA under the Commerce Clause\textsuperscript{39} and the Supremacy Clause.\textsuperscript{40}

\textbf{B. FERC v. Mississippi: Challenging Federal Regulation}

The State of Mississippi and the Mississippi Public Service Commission brought an action against the FERC and the Secretary of Energy in the United States District Court for the Southern District of Mississippi.\textsuperscript{41} Mississippi sought a declaratory judgment that Titles I and II and section 210 of PURPA are unconstitutional because they exceed the Commerce Clause and constitute an invasion of state sovereignty, violating the Tenth Amendment.\textsuperscript{42} The district court ruled in Mississippi's favor, relying on \textit{Carter v. Carter Coal Co.}\textsuperscript{43} The FERC appealed directly to the Supreme Court.\textsuperscript{44} The Supreme Court overruled the district court's Commerce Clause analysis, citing \textit{Hodel v. Indiana}\textsuperscript{45} for the "rational basis" standard for assessing the validity of federal legislation. That is, courts reviewing federal statutes need only examine Congress' findings for a rational basis or reason for application of the Commerce Clause.\textsuperscript{46} The Court then reviewed committee hearings and other data from both houses of Con-

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\item[36.] See Martin, supra note 3, at 156. PURPA expanded the scope of regulation by the FERC over electric utilities to include setting standards for retail electric rates, exempting QFs from state regulation and requiring utilities to purchase electric power from QFs. \textit{Id.} at 154, 168.
\item[37.] See generally 456 U.S. at 742; American Elec. Power v. FERC, 675 F.2d 1226 (D.C. Cir. 1982). See generally 456 U.S. at 742; American Elec. Power v. FERC, 675 F.2d 1226 (D.C. Cir. 1982); Martin, supra note 3, at 169 ("In expanding the scope of FERC's authority, recognition had to be made of the historically limited exercise of federal power and the major role played by state public utility commissions in regulating utilities.").
\item[38.] See 456 U.S. at 742.
\item[39.] U.S. Const. art. I, § 8, cl. 3 (Congress has the power "[t]o regulate Commerce . . . among the several States . . . ").
\item[40.] U.S. Const. amend. VI, cl. 2.
\item[41.] See 456 U.S. at 742.
\item[42.] \textit{Id.} U.S. Const. amend. X provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."
\item[43.] 298 U.S. 235 (1936).
\item[44.] See 456 U.S. at 742.
\item[45.] 452 U.S. 314 (1981).
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and concluded that PURPA was rationally based on Congress's power to regulate commerce.\footnote{47} The Supreme Court then addressed the FERC's use of "state regulatory machinery" to advance federal goals under the Tenth Amendment.\footnote{49} The Court analyzed three specific PURPA provisions: section 210 of PURPA, which requires states to enforce the FERC's standards; Titles I and III, which direct states to consider certain rate-making standards; and PURPA's imposition of certain federal procedures upon state utility commissions.\footnote{50}

Addressing these issues in order, the Court first ruled that section 210 was not intrusive upon the states—the "congressional determination that the federal rights granted by PURPA can appropriately be enforced through state adjudicatory machinery" was adequately supported by congressional findings.\footnote{51} Next, the Court determined that Titles I and II do not compel states to enact legislation and are therefore constitutional.\footnote{52} Finally, the Court reasoned that Congress can require a state to "consider" certain proposed regulations and Congress may also suggest "certain procedural minima as [the state] goes about undertaking its tasks."\footnote{53} Although PURPA was upheld, its constitutionality continues to be questioned by many states who adopt the reasoning from the dissenting portions of Justice Powell's and Justice O'Connor's opinions.\footnote{54}

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\item \footnote{47} 456 U.S. at 756-57. The Court noted that House and Senate Committee Reports revealed that the electric industry consumed more than 25% of total energy resources used in this country, while supplying only 12% of the user demand for energy. \textit{Id.} (citing S. REP. NO. 95-442, 95th Cong., 2d Sess. 7-8 (1977); H.R. REP. NO. 95-496, 95th Cong., 2d Sess., pt. 4, at 125 (1977)). The evidence before Congress showed that contribution by cogenerators alone could provide 7-10% of the United States' generating capacity by 1987. S. REP. NO. 95-442, 95th Cong., 2d Sess. 21, 23 (1977).
\item \footnote{48} 456 U.S. at 758-59. The Court stated that "Congress was not irrational in concluding that limited federal regulation of retail sales of electricity and natural gas, and of relationships between cogenerators and electric utilities, was essential to protect interstate commerce." \textit{Id.} at 758.
\item \footnote{50} Id. at 758-60.
\item Justice Powell, who concurred in part and dissented in part, wrote that the procedural requirements aspect of PURPA "imposes unprecedented burdens on the state" because it "forces federal procedures on state regulatory agencies." 456 U.S. at 771. Justice O'Connor also wrote a separate opinion in which she stated that regulation under PURPA "directly impairs the power of state utility commissions to discharge their traditional functions efficiently and effectively" and is unconstitutional because it regulates the "states as states." \textit{Id.} at 781.
\item Justice Blackmun noted that procedural requirements under Mississippi law are actually in accord with the federally imposed requirements and cannot, therefore, be characterized as overly burdensome. \textit{Id.} at 771 n.34.
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A. Facts and Procedural History

In 1991, the California Public Utility Commission, in conjunction with state utilities, created an implementation program that authorized utilities to monitor and enforce QF compliance with federal operating and efficiency standards under PURPA Title II. The program allowed a utility to cease payment of rates specified in the contract and substitute a lower, "alternative rate" (eighty percent of the avoided cost rate) if a QF failed to meet the federal standards. A utility could also obtain reimbursement for payments from the QFs for any time period during which the QF was not meeting federal standards. In addition, a utility could suspend parallel operation with any QF not in compliance if it determined that the continued operation would burden the utility or its customers. Independent Energy Producers, a trade association of independent power producers, brought an action against the CPUC, seeking a temporary restraining order to prevent the CPUC from implementing its program, claiming that the program intrudes on federal regulatory power.

The United States District Court for the Northern District of California granted summary judgment in favor of the CPUC. The Court of Appeals for the Ninth Circuit reversed the district court and held that the program was federally preempted insofar as the utilities were authorized to enforce PURPA requirement.

B. Federal Preemption: Status Determinations

The Ninth Circuit began its analysis of the CPUC program with a discussion of the Supremacy Clause. The court stated that federal preemption occurs when:

> Congress, in enacting a federal statute, expresses a clear intent to preempt state law, when there is outright or actual conflict between federal and state law, where compliance with both federal and state law is in effect physically impossible, where there is implicit in federal law a barrier to state regulation, where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the states to supplement federal law, or where state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress.

55. See IEP, 36 F.3d at 849.
57. See IEP, 36 F.3d at 852.
58. See id. at 849.
59. See id.
60. See id.
61. Id. at 853 (quoting Louisiana Pub. Serv. Comm'n v. FCC, 746 U.S. 355 (1986)).
The Ninth Circuit determined that the CPUC program was preempted by PURPA; that section 201 of PURPA gives the FERC the sole power to make QF status determinations. The court found: that the CPUC program authorized utilities to alter rates paid to QFs according to their compliance with federal efficiency standards: It then determined that this procedure amounted to a "status determination" by the CPUC because the "CPUC program usurps the [FERC's] authority by authorizing the utilities to determine whether a QF is in compliance with federal efficiency standards." According to the Ninth Circuit's analysis, because the CPUC program allows utilities to substitute alternative rates for non-complying QFs, it conflicts with PURPA and is thus preempted by PURPA.

The Ninth Circuit rejected the district court's finding that QF status determinations are not exclusively the domain of the FERC. The district court had held that, under PURPA, utilities may refuse to enter into agreements with cogenerators, and this indicates that utilities play a role in assessing cogenerator compliance with PURPA. In disagreement, the Ninth Circuit stated that once the FERC assigns QF status to a cogenerator, a utility may not decline to purchase electricity from that facility based on its non-compliance with FERC standards, but the utility may attempt to have the QF decertified through FERC procedures. Deviation from this procedure "could result in [utility] determinations that are inconsistent with this federal scheme and would, in effect, afford certification by the Commission little or no deference."

C. State's Roles in Implementing PURPA

The Ninth Circuit addressed the district court's conclusion that the state's broad rate-making authority under PURPA provides the state with a concurrent role in enforcing QF compliance with federal efficiency standards. The appellate court noted that states are granted broad authority to implement rules under section 210(a) of PURPA, and states play a primary role in calculating avoided costs and overseeing contractual relationships between QFs and utilities. However, state power to implement rules prescribed by the FERC under section 210 does not include the power to set standards under which a facility is deemed a QF. Section 210 is limited to determining the utility's avoided costs and establishing standards to ensure the safety and reliability of a QF.

Additionally, the Ninth Circuit refuted the district court's interpretation of 18 C.F.R. § 292.304(e)(2)(iii) with regard to the state's power to

63. *Id.*
64. *Id.* at 855.
66. *IEP*, 36 F.3d at 855.
67. *Id.* at 856.
68. *Id.*
69. *Id.* (noting that status determinations are covered under PURPA § 201, not § 210).
“sanction” inefficient QFs. The district court reasoned that subsection (iii)’s reference to “sanctions for noncompliance” authorizes the state to sanction non-complying QFs. In opposition to the district court’s finding, the Ninth Circuit stated:

[§ 292.304 (e) (2) (iii)] simply recognizes that the value of electric energy provided by the QF varies depending on the terms of its commitment to the utility, the length of time during which the QF has guaranteed that it will supply electric energy to the utility, the certainty and dependability of the supply, and the existence in the contract of penalty provisions for the breach of any contractual obligations.

Although a contract between a utility and QF may contain sanction provisions for noncompliance, “[§ 292.304 (e) (2) (iii)] . . . does not authorize the state to decertify or penalize on account of a QFs failure to comply . . . .” Nor may a utility unilaterally determine whether the QF has violated its guarantee to comply with federal standards.

D. “Alternative” Avoided Costs: Just and Reasonable

The CPUC maintained that paying the alternative rate would promote efficiency and prevent ratepayer subsidization of inefficient QFs. The Ninth Circuit ruled that efficiency is not a consideration when determining the avoided cost, but that efficiency is only relevant when determining whether a facility is a QF. Under the Ninth Circuit’s holding, the CPUC may not authorize utilities to set “alternative” avoided cost rates based on the QFs efficiency simply to insure “just and reasonable” rates in the public interest.

The Ninth Circuit bolstered its reasoning by referencing Congress’s determination that a “just and reasonable” rate is the full avoided cost provided by PURPA. The court noted that neither the state, nor the utilities could unilaterally modify the terms of standard offer contracts with QFs, because QFs are entitled to deliver energy to utilities at an avoided cost.

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70. In pertinent part, 18 C.F.R. § 292.304(e) (1995) provides:
(e) Factors affecting rates for purchases. In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(2) The availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:
(i) The ability of the utility to dispatch the qualifying facility;
(ii) The expected or demonstrated reliability of the qualifying facility;
(iii) The terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for noncompliance.

71. IEP, 36 F.3d at 856.
72. Id. at 857.
73. Id.
74. Id.
77. 36 F.3d at 858.
rate calculated at the time the contract is signed. Therefore, if the QF is not in compliance, a utility is only authorized to petition the FERC to decertify the QF.

E. Decision

The Ninth Circuit reversed the district court's summary judgment in favor of the CPUC and ruled that CPUC's program is preempted by PURPA insofar as it authorizes the utilities to determine that a QF is not meeting federal efficiency standards. The circuit court did not preempt the CPUC program's QF-monitoring provisions. The circuit court held that requiring QFs to submit operating data to utilities does not impose undue burden on the QFs, nor does it affect a status determination. If the data shows that a QF is not in compliance with the federal standards, the utility may only petition the Commission to revoke the facility's QF status; it may not take action to sanction the QF.

IV. Analysis

A. The Supremacy Clause: Justifying Federal Preemption

The Ninth Circuit determined that the CPUC program conflicts with PURPA and is therefore preempted. While the court enlists a broad interpretation of the CPUC program, it narrowly interprets a state's authority under PURPA. The result is federal preemption. The court specifically cited *Louisiana Public Service Commission v. FCC (LPSC)*. The court set out several factors defining preemption as set forth by *LPSC*: 1) congressional intent; 2) conflict between federal and state law; 3) whether compliance with both federal and state law is physically impossible; 4) whether there is implicit in federal law a barrier to state regulation; 5) whether Congress has legislated comprehensively, thus occupying an entire field of regulation; and 6) whether the state law stands as an obstacle to the accomplishment of the Congressional purpose.

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78. *Id.* The avoided costs in the standard offer contracts were incorrectly calculated according to the future cost of fossil fuels. *Id.* at 852. The FERC noted that although the costs calculated and set forth in the contracts might be greater or less than the utility's current avoided costs, in the long run, "overestimation" and "underestimation" would balance out. *Id.* at 858. Contrary to the court's observation, Congress's Comprehensive Report on the Public Utility Regulatory Policies Act makes clear that "full avoided cost" is not a substitution for the "just and reasonable" standard. H.R. REP. No. 1750, 95th Cong., 2d Sess., (1978).


80. 36 F.3d at 859. The court found that the monitoring requirements fall within the state's rate making authority. *Id.* Such information would "allow the utilities to determine if the QF met federal operating and efficiency standards." *Id.*

81. *Id.* at 857. The CPUC agreed that the Commission has ultimate authority to certify and decertify QFs. The CPUC asserted that the Program sought only to adjust avoided costs; the QF still receives benefits under PURPA. *Id.*

82. 476 U.S. 355 (1986).


obstacle to the accomplishment and execution of Congress' objectives.\(^8^8\) The court in \(LPSC\) also stated that, "where possible, provisions of a statute should be read so as not to create a conflict."\(^8^9\) An analysis of the CPUC program under the federal preemption factors enumerated in \(LPSC\) reveals that states may sanction inefficient QFs without violating PURPA.

1. Conflict vs. Cooperation

States have been given wide latitude to implement PURPA.\(^9^0\) The strong arm of regulatory implementation is the power to sanction. The CPUC attempted to encourage QF efficiency through sanctions in the form of lower rates. The Ninth Circuit maintained that QFs are entitled to receive the full avoided cost rate rather than some altered rate.\(^9^1\) However, PURPA allocates to the states the primary role in calculating avoided costs and overseeing the contractual relationship between QFs and utilities.\(^9^2\) Under the FERC's regulations, a state agency may consider sanctions for non-compliance when calculating avoided costs.\(^9^3\) Through this express power a state may provide for an altered rate to be paid to QFs which fail to meet efficiency standards. The Ninth Circuit narrowly construes the state's ratemaking power and asserts that a "QF's efficiency is entirely unrelated to the utility's avoided costs."\(^9^4\)

The Ninth Circuit began its analysis with the premise that authorizing utilities to pay "alternative" rates to inefficient QFs essentially authorizes the utilities to perform QF status determinations. The CPUC did not create the program to allow utilities to make status determinations. Rather, when the CPUC created alternative rates it exercised its ratesetting power under PURPA. The CPUC authorized utilities to use these "alternative" rates when a QF falls short of federal standards. The alternative rate is simply a sanction imposed on a QF for failing to comply with federal regulations.\(^9^5\) It does not strip the facility of its QF status or deprive the facility of other QF benefits enumerated under PURPA.

The CPUC program does not appear to conflict with the goals of PURPA, nor does it conflict with an express or implied provision in PURPA.\(^9^6\) The program actually works to further the goals of PURPA by

\(^{8^8}\) Hines v. Davidowitz, 312 U.S. 52, 67 (1941).
\(^{8^9}\) 476 U.S. at 370. The court rejected a narrow interpretation of § 152 (b) of the Communications Act. \(Id\). Instead, the court followed the rule of construction that technical terms of art should be interpreted by reference to the trade or industry in which they apply. \(Id\).
\(^{9^0}\) \(IEP\), 36 F.3d at 856.
\(^{9^2}\) \(IEP\), 36 F.3d at 856.
\(^{9^4}\) \(IEP\), 36 F.3d at 857.
enforcing FERC regulations. Further, the program authorizes the utilities to take action to encourage the QF to operate at its expected efficiency level. The result is a cooperative effort by the CPUC and the FERC to successfully enforce federal regulations and ensure QF compliance with PURPA.\footnote{97}

It is reasonable to allow the utility to sanction a QF, rather than force it to accept inefficiently produced electricity or to petition the FERC to revoke the QF status.\footnote{98} A sanction is flexible and can encourage a troubled QF to rectify its inefficiencies without removing the protections PURPA provides.

2. State Autonomy

As previously noted, the states play a role in PURPA implementation. Congress did not legislate comprehensively in the area of utility/cogeneration regulation. On the contrary, Congress expressly provided for state involvement in PURPA. Congress authorized the states to set avoided cost rates and regulate contracts between the QFs and utilities—not the FERC.\footnote{99} The Ninth Circuit's decision in IEP appears to redistribute Congress's allocation of authority under PURPA.

In IEP, the Ninth Circuit correctly urged that, "as a policy matter, a uniform federal decisionmaker" is necessary for QF certification;\footnote{100} however, Congress legislated PURPA implementation to the states. The states calculate avoided cost rates and govern contractual relationships between QFs and utilities. Although uniformity is ideal, PURPA affords each state some flexibility in fulfilling its implementation duties under PURPA.

The state agency or local utility is in a better position to monitor QF performance than a federal decision maker. To enforce PURPA effectively, a state implementation program may provide some repercussion for failure to comply with the federal standards. Under PURPA, a state should be able to use its ratemaking power to create an "alternative," avoided cost as a sanction for non-compliance.

Additionally, each state has provided an interest in the contractual dealings between utilities and QFs. The CPUC expressed concern regarding "ratepayer subsidization of inefficient QFs."\footnote{101} The IEP court held that, as a QF, the facility is entitled to the full avoided cost rate, regardless of whether it is running at the required efficiency level.\footnote{102} Such treatment

\footnote{98. 18 C.F.R. §§ 292.207(d)(1), 385.207(a)(2) (1995).}
\footnote{99. Id. See also Southern Cal. Edison Co. and San Diego Gas & Elec. Co., 70 F.E.R.C. ¶ 61,215 (1995). In his comments submitted to the FERC regarding the San Diego proceeding, Congressman Charles Wilson stated that "nothing in PURPA gives [the] FERC the power to second-guess states when calculating avoided costs or states' findings that rates are at or below avoided costs."}
\footnote{100. IEP, 36 F.3d at 857.}
\footnote{101. Id. at 857.}
\footnote{102. The FERC has stated that giving an unfair advantage over other market participants (non-QFs) will "hinder the development of competitive markets and hurt ratepayers, a result clearly at odds
of QFs does not encourage the QF to comply with PURPA, nor to compete with conventional facilities.

**B. The CPUC Program’s Fatal Flaw: Depriving a QF of the Benefit of the Bargain**

Although the states and utilities may impose sanctions on the QF for non-compliance, the Ninth Circuit points out that the CPUC and the utilities may not unilaterally modify the terms of the standard offer contracts by substituting a lower rate. The standard offer contracts negotiated by utilities and QFs in 1982 provided for fixed cost rates that were based on the anticipated future cost of fossil fuels. The program allows utilities to disregard the price stated in the contract and substitute the “alternative” price if the QF is not meeting federal efficiency standards. Although the contract contains provisions under which the QF guarantees its compliance with the efficiency standards set forth in PURPA, the utilities may not unilaterally determine that a violation has occurred and therefore substitute an “alternative” rate. Under *Smith Cogeneration* and *Freehold Cogeneration*, this type of contract alteration deprives a QF of the benefits of the bargain.

In *Smith Cogeneration*, the Oklahoma Supreme Court held that Rule 58(h) promulgated by the Corporation Commission was preempted by PURPA. Under Rule 58(h), the Corporation Commission required utilities and QFs to include a notice provision in approved contracts allowing reconsideration of estimated avoided costs once a QF is obligated to deliver power. The court ruled that allowing reconsideration of a long-term contract imposes utility-type regulation on the QFs in violation of PURPA. Once the Commission approves the contract, it may not be unilaterally altered. The Third Circuit’s decision in *Freehold Cogeneration Associates* echoes the holding of *Smith Cogeneration*.

In *Freehold Cogeneration*, Jersey Central Power and Light (JCPL) and Freehold entered into a power purchase agreement (PPA), which was approved by the Board of Regulatory Commissioners (BRC) on July 8, 1992. In 1993, JCPL reviewed its contract with Freehold and concluded that the arrangement was no longer economically beneficial because the


*IEP*, 36 F.3d at 857.

*Smith Cogeneration*, 863 P.2d 1227.

*Freehold Cogeneration Assocs.*, 44 F.3d 1178.

Id. at 1240.

*Id.* See also 45 Fed. Reg. 12,224 (1980).

See, e.g., *West Penn Power Co.*, 71 F.E.R.C. ¶ 61,153 (1995) (holding that a state regulatory authority can modify a contract negotiated between a QF and a utility prior to its approval).

*Freehold Cogeneration Assocs.*, 44 F.3d 1178.

Id. at 1182.
contracted avoided cost was significantly higher than the utility's cost.\textsuperscript{113} Freehold rejected JCPL's proposed buy-outs and subsequent negotiations. By order dated January 5, 1994, the BRC directed the parties to renegotiate the purchase rate term of the PPA or negotiate a buy-out of the PPA.\textsuperscript{114} Freehold filed an action on January 14, 1994, seeking a judgment declaring that the BRC's order is preempted by PURPA. The Third Circuit held that the order violated PURPA, stating that "once the BRC approved the power purchase agreement between Freehold and JCPL . . . any action or order by the BRC to reconsider its approval or to deny the passage of those rates to JCPL's customers under purported state authority was preempted by federal law."\textsuperscript{115}

The CPUC's program endeavored to sanction inefficient QFs in a manner contrary to the holdings in \textit{Smith Cogeneration} and \textit{Freehold Cogeneration}. The CPUC may empower utilities to sanction QFs using "alternative" rates through its ratemaking power under PURPA; such rates or sanctions, however, must be part of the negotiated contract. The CPUC cannot "revisit" a previously approved contract by substituting altered rates. The validity of the CPUC's program deserved the type of analysis employed in \textit{Freehold Cogeneration}\textsuperscript{116} and \textit{Smith Cogeneration}\textsuperscript{117} since the same issue arises: whether a utility can revisit a contract and alter the rates offered without re-negotiating. In \textit{Freehold Cogeneration} and \textit{Smith Cogeneration}, this question was answered in the negative. Under these rules, the CPUC's mistake was its attempt to empower the utilities to impose these sanctions unilaterally, where the utility had the ability to create the sanction by contract.

Utilities and QFs may negotiate penalty provisions in a PPA,\textsuperscript{118} as well as regulatory-out clauses.\textsuperscript{119} As demonstrated by \textit{Smith Cogeneration} and \textit{Freehold Cogeneration}, once the PPA is approved by the state commission the terms of the PPA may not be altered through forced negotiations or substitution of rates. Alteration of long term contracts by states or utilities reduces the certainty of a QF's revenue stream and its ability to finance, thus hindering the QF's economic development.\textsuperscript{121} In addition, when a utility determines that a PPA has become economically burdensome, the QF

\textsuperscript{113} Id. at 1183.
\textsuperscript{114} Id.
\textsuperscript{115} Freehold Cogeneration Assocs., 44 F.3d at 1194. See West Penn Power Co. v. Pennsylvania Pub. Util. Comm'n, 569 A.2d 1055, 1066 (Pa. 1995) (holding that PURPA bars reconsideration of prior approval of an agreement to purchase energy from a QF absent some basis in the law of contracts which justifies setting the earlier contract aside).
\textsuperscript{116} West Penn Power Co.,569 A.2d at 1178.
\textsuperscript{117} Smith Cogeneration, 863 P.2d 1227.
\textsuperscript{118} See IEP, 36 F.2d at 856.
\textsuperscript{119} Freehold Cogeneration Assocs., 44 F.3d at 1193 (the court recognized the validity of regulatory out clauses as "waivers" of PURPA requirements. However, the specific clauses in the JCPL/Freehold contract did not "surrender any of the protection from state rate regulation conferred on Freehold by section 210(a) [of PURPA]"). Id. See 18 C.F.R. § 292.301(b) (1995).
\textsuperscript{120} See Freehold Cogeneration Assocs., 44 F.3d at 1178. Smith Cogeneration, 863 P.2d at 1227.
may propose a buy-out or buy-down\textsuperscript{122} of the PPA, but the QF cannot be forced into the agreement.

V. Conclusion

Although the CPUC is preempted by PURPA, the Ninth Circuit's analysis of the program seems inconsistent with PURPA's intent. Under PURPA, states have broad ratemaking power, and thus, state PUCs may formulate "alternative" rates and authorize utilities to sanction QFs using these "alternative" rates. The use of sanctions for non-compliance does not effect a QF status determination. The Ninth Circuit ruled, however, that PURPA preempts the program because it usurped the FERC's power under PURPA to make QF status determinations.

The error in the CPUC program, however, did not involve empowering utilities to sanction QFs. The program violated PURPA by authorizing utilities to unilaterally alter rates in the approved standard offer contracts. Under the Smith Cogeneration and Freehold Cogeneration decisions, utilities and states may not revisit an approved PPA and alter contracted rates without the QF's agreement. State PUCs and utilities can provide for penalties, but not after the PPA has been approved by the parties and the state PUC.

The effect of the IEP decision may be to discourage state autonomy in PURPA implementation. A state implementation plan that contains sanction provisions for non-compliance can be an effective PURPA enforcement tool. However, the Ninth Circuit does not accept the CPUC's attempt to enforce PURPA through sanctions. Under the IEP decision, state PUCs will have to test the waters and risk preemption to determine methods to effectively enforce FERC regulations which survive judicial scrutiny.

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