

Report of the Legislative and Regulatory Reform Committee

This Report concerns the legislative activities of the second session of the 100th Congress during 1988 and actions of the Federal Energy Regulatory Commission (FERC or Commission) of major regulatory significance during 1988. This Report will review those actions of Congress and the Commission which will have a material impact on the practice of the members of the Federal Energy Bar Association. Other matters which received considerable attention during 1988, but were not resolved, are also reviewed. Matters like acid rain, global warming, and anti-bypass legislation are very likely to be considered again by Congress.

I. CONGRESSIONAL MATTERS

A. *Free Trade Agreement*

Both the U.S. House of Representatives and the U.S. Senate passed by overwhelming majorities the U.S.-Canada Free Trade Agreement.¹ This Agreement eliminates all tariffs and many trade barriers between the two nations over the next ten years. With Prime Minister Mulroney's reelection, approval by the Canadian Parliament was assured. The energy provisions of the Free Trade Agreement affect the trade between Canada and the U.S. in crude oil, petroleum products, natural gas, electricity, uranium, and coal. The energy provisions, in general, prohibit the laws and regulations of either of the signature countries from discriminating between the energy goods of either country based upon nationality. The Act eliminates important export restrictions, including energy export taxes and export price requirements.

The provisions that no law or regulation of either country discriminate on the basis of nationality includes the decisions and regulations of the FERC and the Economic Regulatory Administration. In essence, the intent of the Agreement is that the energy goods of either country can compete in the other country's market without regulatory barriers.

Under the "statement of administrative actions," which was sent to Congress by President Reagan along with the Free Trade Agreement, no change in federal law in the regulation of natural gas or electricity is required to be made. The standards under the Natural Gas Act (NGA),² Natural Gas Policy Act (NGPA),³ and the Federal Power Act (FPA)⁴ are to be implemented without change.

1. United States-Canada Free-Trade Agreement Implementation Act of 1988, Pub. L. No. 100-449, 102 Stat. 1851 (1988).

2. Natural Gas Act of 1935, 15 U.S.C. §§ 717-717(w) (1982).

3. Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982).

4. Federal Power Act, 16 U.S.C. §§ 791(a)-828(c) (1982).

B. Price-Anderson Reauthorization Act

On August 20, 1988, the President signed into law the Price-Anderson Reauthorization Act.⁵ This Act increased nuclear liability insurance from \$710 million to \$7 billion for claims resulting from accidents at Department of Energy nuclear facilities and commercial nuclear facilities. The Congress extended this insurance provision until August 1, 2002.

C. Race to the Courthouse

On January 8, 1988, the President signed into law a bill which eliminates the "races to the courthouse" by parties filing appeals in various circuits.⁶ This legislation establishes a ten-day period after the issuance of a contested agency order under which all appeals filed in various circuit courts are considered to be filed contemporaneously. If more than one circuit court receives an appeal within the ten-day time period, a judicial panel is to select on a random basis the court in which all petitions for review are to be heard. Petitions filed in other courts are to be consolidated in the chosen court.

The legislation also requires federal agencies to designate a person within the agency to receive petitions for review. In Order No. 504,⁷ issued on September 21, 1988, the Commission designated the FERC Secretary to receive court-stamped copies of petitions for review filed in a U.S. Circuit Court of Appeals. A more detailed discussion of the legislation and the Commission's implementation of it is contained in the Report of the Committee on Judicial Review.

D. Jurisdiction Over Multi-state Local Distribution Companies

The NGA was amended in order to clarify that the local transportation of natural gas by distribution companies which have operations in more than one state is a matter within the jurisdiction of the State Regulatory Commission and subject to state regulation.⁸ The purpose of this legislation is to assure uniformity in regulatory jurisdiction over natural gas transportation of a single local distribution company. This bill affects less than ten local distribution companies in the nation.

E. Regulatory Fairness Act

The Regulatory Fairness Act⁹ was enacted into law on October 6, 1988, allowing the FERC to order refunds to wholesale electric customers found by the FERC to have paid unreasonably high rates. This amendment to the Federal Power Act is intended to create symmetry in the FERC's treatment of rate increases and rate decreases. Under previous law, reductions in wholesale electric rates were effective as of the date on which the FERC issued its decision. Now, under amended section 206 of the Federal Power Act, refunds to

5. Price-Anderson Amendments Act of 1988, Pub. L. No. 100-408, 102 Stat. 1066 (1988).

6. Pub. L. No. 100-236, 101 Stat. 1731 (1988).

7. Order No. 504, 53 Fed. Reg. 37,545 (1988).

8. Uniform Regulatory Jurisdiction Act of 1988, Pub. L. No. 100-474, 102 Stat. 2302 (1988).

9. Regulatory Fairness Act, Pub. L. No. 100-473, 102 Stat. 2299 (1988).

wholesale customers from rate reductions are to be retroactive to the date the request is filed. The refunds are limited to a retroactive period of fifteen months.

F. Amendment to NGPA

Congress amended the NGPA to remove certain contract duration and right of first refusal requirements for Outer Continental Shelf (OCS) gas. The amendment removed section 315(a)(3) and 315(b) from the NGPA. Section 315(a)(3) required that contracts for sale of new OCS gas priced under NGPA section 102 or NGPA section 107(c)(1), (2), (3), and (4) must extend for fifteen years or the commercial life of the reservoir. Section 315(b) of the NGPA required that as these OCS contracts expired the seller was required to grant the original purchaser the right of first refusal.

This bill eliminates the minimum fifteen-year duration requirement for sales contracts of purchases from OCS reservoirs of new gas under section 102(b) or high cost gas under section 107(c)(1), (2), (3) and (4). The repeal of NGPA section 315(b) removes the right of first refusal obligation for OCS gas, which qualifies as new gas under section 102(c), as new off-shore production gas under section 103(c), or as high cost gas under section 107(c)(1), (2), (3), and (4).

These provisions of the NGPA were repealed because it was thought that they inhibit efficient market operation in today's fast-paced natural gas market.

II. FEDERAL ENERGY REGULATORY COMMISSION MATTERS

A. Notices of Proposed Rulemaking Concerning The Implementation Of The Public Utility Regulatory Policies Act (PURPA)

On March 16, 1988, the FERC issued three notices of proposed rulemaking (NOPRs) regarding administration of avoided cost, competitive bidding and independent power producers (IPP).¹⁰ The Commission issued a fourth NOPR on July 29, 1988, concerning the regulations governing the Public Utility Regulatory Policies Act of 1978 (PURPA Regulations NOPR).¹¹ These NOPRs embody the Commission's response to the issues raised and discussed during the 1987-1988 Congressional oversight hearings and the 1988 technical conference and regional hearings that were held by the Commission.

1. IPP NOPR

The Commission proposes to relax Federal Power Act regulations for an

10. Notice of Proposed Rulemaking, *Regulations Governing Independent Power Producers (IPP NOPR)*, IV F.E.R.C. Stats. & Regs. ¶ 32,456, 53 Fed. Reg. 9327 (1988); Notice of Proposed Rulemaking, *Regulations Governing Bidding Programs (Bidding NOPR)* IV F.E.R.C. Stats. & Regs. ¶ 32,455, 53 Fed. Reg. 9324 (1988); Notice of Proposed Rulemaking, *Administrative Determination of Full Avoided Costs, Sales of Power to Qualifying Facilities, and Interconnection Facilities (ADFAC NOPR)*, IV F.E.R.C. Stats. & Regs. ¶ 32,457, 53 Fed. Reg. 9331 (1988).

11. Notice of Proposed Rulemaking, *Regulations Governing the Public Utility Regulatory Policies Act of 1978*, IV F.E.R.C. Stats. & Regs. ¶ 32,465, 53 Fed. Reg. 31,021 (1988).

IPP that:¹² (1) does not qualify as a qualifying facility (QF); (2) sells power from an independent power facility;¹³ (3) is not affiliated with the franchised utility in the area in which the IPP is selling; and (4) lacks significant market power.¹⁴ The Commission proposes to accept as just and reasonable IPP rates that are determined through competitive bidding or rate negotiations.¹⁵ These rates are, however, subject to a price cap which is based on the purchaser's current or projected incremental cost.

The Commission also proposes to waive all or part of its regulations concerning corporate and financial regulation of IPPs, sale and disposition of facilities, issuance of securities, accounting, reporting and recordkeeping.¹⁶ Finally, the Commission proposes to establish procedures for advanced certification of an IPP's status. Unlike utility purchases from QFs, utility purchases from IPPs will be strictly voluntary.

2. Bidding NOPR

Pursuant to the Bidding NOPR, states will have the option to use competitive bidding to price power purchased from QFs for all, some or none of a purchasing utility's capacity needs.¹⁷ Under the bidding system, bidders would compete to supply capacity and associated energy. Utilities would not have to purchase capacity from losing QFs or QFs that did not participate in bidding, but would still have to purchase energy.

Any state that voluntarily establishes a bidding system would be required to follow these mandatory conditions: (1) to ensure that QFs are paid no more than the utility's avoided cost, all sources must be taken into account either by allowing direct participation by all sources in the bidding or by inclusion of all sources in calculating the utility's avoided cost that would be used as a benchmark; (2) utilities must provide written explanations of their decisions concerning non-price factors, e.g., reliability and fuel diversity, that are included in the bidding process; (3) utilities must publicize certain information in advance of solicitation; (4) utilities must treat all bidders equally; (4) utilities must file with the state regulatory authority a written explanation of their evaluation, selection and bidding process; (5) all bids must be submitted contemporaneously; (6) states must certify the price and selection of winning bids; (7) set asides are permitted for certain technologies and fuels, provided QFs

12. IV F.E.R.C. Stats. & Regs. ¶ 32,456, at 32,103-12.

13. An independent power facility is defined as a facility or portion of a facility that is not in any utility's rate base and not otherwise afforded assurance of cost recovery under cost-of-service regulation. *Id.* at 32,110.

14. The Commission proposes that a seller is not likely to have a significant market power over a wholesale purchaser if it sells power from a plant not subject to cost-of-service regulation to a purchaser (1) that is not located in the seller's retail franchise area; and (2) that is not served by transmission facilities that are essential to the purchaser and controlled by the seller. Control of transmission facilities supplying less than 50% of the energy needs of a customer would not be considered essential, absent proof to the contrary. *Id.* at 32,110-11.

15. *Id.* at 32,127.

16. *Id.* at 32,123-30.

17. IV F.E.R.C. Stats. & Regs. ¶ 32,455, at 32,024-25.

are given an opportunity to satisfy a utility's capacity needs.¹⁸

In addition to these conditions, the Commission also proposes certain non-mandatory guidelines: (1) the Commission encourages all source bidding (including direct bidding by subsidized technologies) and consideration of demand side alternatives to capacity expansion, conservation programs and load management; (2) utilities would select the winning bidders who would be held to the prices bid; (3) QFs smaller than one MW would be exempt from bidding; (4) bidding would be held only when there is a need for new capacity; (5) if there is a tie, QFs would be preferred.¹⁹ The Commission also proposes to waive the efficiency standard for oil and gas-fired facilities that are selected as winning bidders.

The Bidding NOPR includes two wheeling proposals.²⁰ Under the Wheeling-In Proposal, a utility that wishes to bid for the capacity needs of another utility must provide firm transmission service to the purchasing utility for successful bidders that are located within the bidding utility's own service territory or are capable of reaching one of its interconnection points. Under the Wheeling-Out Proposal, a utility's bid in a bidding program held to satisfy its own capacity needs would be conditioned on that utility's agreement to wheel power to other utilities that border its service area for any losing bidder who wants to sell to another wholesale purchaser.

3. ADFAC NOPR

The ADFAC NOPR reaffirms the avoided cost standard as the appropriate basis for determining rates for purchases from QFs. It also provides states with guidelines in determining avoided cost.²¹ For example, no capacity payments will be available once the purchasing utility's capacity needs have been met. States must explain, in writing, why certain wholesale sources are excluded from the determination of avoided cost and how they considered certain factors in setting QF rates, *e.g.*, the quantity and characteristics of the power needed and the QF's ability to meet those needs. If the amount of capacity offered by QFs exceeds the utility's needs, states should consider whether to redetermine a utility's avoided cost. Such redeterminations would be effective prospectively. Moreover, states must require that standard rates be offered to all QFs of one MW or less capacity. States have the option to require that standard rates be offered for facilities larger than one MW. Finally, states may not require a utility to buy QF power at a rate exceeding the utility's avoided cost.

Any long-term contracts with levelized payments must: (1) be based on an estimate of avoided cost over the term of the contract or other legally enforceable obligation; (2) not result in total payments in excess of the utility's total avoided cost at the time the obligation is incurred; and (3) consider the time value of money, the QF's financing needs and inter-generational equity

18. *Id.* at 32,025-43.

19. *Id.*

20. *Id.* at 32,045-47.

21. IV F.E.R.C. Stats. & Regs. ¶ 32,457, at 32,171.

problems.²²

The Commission proposes to allow QFs to construct and own interconnection facilities and transmission lines which are used to deliver power to and from the purchasing utility.²³

4. PURPA Regulations NOPR

The major issues discussed in the PURPA Regulations NOPR concern: FERC certification procedure; QF ownership; useful thermal energy output; definition of waste; use of fossil fuel; and sequential use of energy.

a. FERC Certification Procedure

The Commission proposes to eliminate FERC certification QFs and give QFs the certainty of self-qualifying status by filing an affidavit with the Commission and the utility. The affidavit would describe the facility and state that the facility meets the Commission's requirements. A utility would have ninety days after receiving the affidavit to file any objections with the FERC. If a utility fails to file an objection, it would be required to deal with the QF under the Commission's regulations, without insisting on FERC certification. If a facility intends to employ novel technologies or ownership arrangements, the FERC proposes that the QF apply for a declaratory order.²⁴

If, however, the FERC certification option is not eliminated, the FERC proposes to incorporate two standardized application forms in its regulations.²⁵ If there are any minor changes in the QF, the Commission proposes to require that the QF merely file a letter notifying the Commission of the minor changes. Any filing notifying the Commission of major modifications to the QF would be treated as an original filing for certification of QF status.

b. QF Ownership

The Commission proposes to eliminate the "upstream" attribution of utility ownership by allowing utility subsidiaries to own 100% of QFs, provided the utility subsidiary does not sell power to its affiliates.²⁶ In defining when a company is "primarily engaged" in the sale of non-QF power, the Commission proposes using a revenue test, *i.e.*, a person would be permitted to own a QF if that person has a business that is not primarily that of a utility, but who may sell some power that is not from a QF.

c. Useful Thermal Output

In determining whether there exists a *bona fide* useful thermal energy output for purposes of meeting the 5% operating standard, the Commission

22. *Id.* at 32,171-73.

23. *Id.* at 32,181-82.

24. IV F.E.R.C. Stats. & Regs. ¶ 32,465, at 32,291.

25. *Id.* at 32,292.

26. *Id.* at 32,304.

proposes to require that the applicants demonstrate that the revenues received from the sale of heat or steam are equal to or greater than the cost of an equivalent quantity of the QF's fuel input.²⁷ This revenue test requires that the applicant sell heat or steam at a price that would at least compensate for the cost of fuel consumed to provide it. If a thermal user is not affiliated with a QF, evidence of an arms-length transaction indicates economic justification for the thermal use. If the cogenerator and thermal user are affiliated, more documentation or justification is required.

d. Definition of Waste

The Commission proposes to redefine waste as "an energy source other than biomass that has essentially no commercial value at the time and place in which it is produced."²⁸ The Commission also proposes to adopt a list of specific energy source materials that would be considered waste. Once an application for certification is granted, such certification may not later be revoked because the waste material is later found to have commercial value.

e. Use of Fossil Fuel

The Commission proposes to change the limit on fossil fuel use for small power production facilities by adopting a percentage rule lower than the current 25% limit on small power production facilities.²⁹ Fossil fuel use below such a percentage meets the statutory use and other minor uses permitted by the regulations. The Commission also proposes to eliminate the "essential fixed assets" test. *i.e.*, whether the proposed use of fossil fuel enhances the efficiency of the QF's essential fixed assets.

f. Sequential Use of Energy

The Commission does not propose to change its definition of "sequential use of energy."³⁰ The Commission, however, proposes to modify the definition of a topping-cycle cogeneration facility to allow that only some of the reject heat from power production be used for power production, *e.g.*, industrial thermal process or a heating application. The Commission would only require that thermal energy be extracted somewhere along a chain of turbines linked by a sequential energy flow.

g. Other Issues

The Commission proposes to codify the definition of power production capacity, *i.e.*, the maximum net output of the QF, as measured at the busbar,

27. *Id.* at 32,312.

28. *Id.* at 32,314.

29. *Id.* at 32,317-18.

30. *Id.* at 32,310.

which can be safely and reliably achieved under the most favorable operating conditions likely to occur over a period of several years.

- The Commission proposes to clarify that the 90-day period for Commission action on QF certification applications does not start until all data needed to complete the application has been submitted.

- The Commission proposes to exempt topping-cycle cogeneration facilities using less than or equal to 50% of the annual energy input from documentary compliance with the efficiency standard.

- To prevent abuses where bottoming-cycle designs with unlimited supplemental firing are used, the proposed supplementary firing standard would require that, on an annual basis beginning with the in-service date, all energy inputs subsequent to thermal use exceed one-half of the energy input into the thermal application.

- Other Commission proposals concern additional application requirements for QFs.

III. CONCLUSION

The Commission is currently considering these NOPRs and all comments related thereto. Some members of Congress have urged the Commission to "go slow" on the NOPRs and to consider related issues like transmission access simultaneously with the NOPRs. To date, the Commission has not indicated when it will finalize the NOPRs, if at all.

Michael D. Gayda, *Chairman*

Johnny J. Akins, *Vice Chairman*

Karyl M. Arnold
Kenneth E. Barden
Noel J. Darce
Marilyn M. Gossel
John K. Keane, Jr.
John Charles Letteri
C.K. Mallory

Kenneth T. Maloney
Mary Anne Mason
David M. Patton
Patrick C. Rock
Don S. Smith
Lyndon C. Taylor
Michael J. Zimmer