

COMPETITIVE BIDDING AND INDEPENDENT POWER PRODUCERS: IS DEREGULATION COMING TO THE ELECTRIC UTILITY INDUSTRY?

John Wyeth Griggs*

I. INTRODUCTION

The Federal Energy Regulatory Commission (FERC) has recently initiated regulatory actions that could largely deregulate the generation of electric power. The FERC issued three notices of proposed rulemaking (NOPRs) on March 16, 1988: administrative determination of full avoided costs (ADFAC), regulations governing competitive bidding programs, and regulations governing independent power producers (IPPs).¹ The FERC proposals were issued ostensibly in response to changes in the electric power industry brought about by the overwhelming response of cogenerators and small power producers to incentives under section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA).² The competitive bidding and IPP proposals, which have been hotly debated in the electric utility industry for over a year,³ have been promoted by the FERC's Chairman Hesse and Commissioner Stalon in public speeches and in testimony to Congress.⁴ The competitive bidding and IPP proposals would attempt to create a market for electric power

* Colgate University, B.A., 1969; Columbia University, J.D., 1973; Partner in the firm of Birch, Horton, Bittner, Cherot and Anderson, P.C., Washington, D.C.

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

2. Title II of the PURPA made several revisions to the Federal Power Act (FPA), including the incentives for cogeneration and small power production reflected in section 210. 16 U.S.C. §§ 824a-3, 824i-k (1982). Titles I, 16 U.S.C. §§ 2605-45 (1982) and III, 15 U.S.C. §§ 3201-11 (1982), of the PURPA addressed state regulation of both electric and natural gas utilities.

3. The FERC's NOPRs were issued following regional conferences and a Washington technical conference to review similar proposals aired by the FERC staff. See Notice of Technical Conference, *Regulation of Independent Power Producers*, 52 Fed. Reg. 36,998 (1987); Notice of Public Conferences and Request for Comments, *Cogeneration; Small Power Production*, 52 Fed. Reg. 2552 (1987); Analysis by the Office of Economic Policy, *Regulating Independent Power Producers: A Policy Analysis* (FERC issued Oct. 13, 1987) [hereinafter *Regulating IPPs*]; Summary of Current Staff Proposals on PURPA-Related Issues (FERC issued Sept. 11, 1987) [hereinafter Summary of Current Staff Proposals]. The FERC consideration of competitive bidding and IPPs and their debate in the industry began in earnest after they were espoused by the FERC's Chairman Hesse in a speech on June 10, 1987 to Edison Electric Institute. *Hesse Outlines Competitive Bidding Options for Electric Generating Capacity*, News Release No. R-87-62 (FERC issued June 10, 1987) [hereinafter FERC News Release].

4. See, e.g., *Hearings Before the Subcomm. on Energy and Power, House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. (1987) (prepared testimony of Chairman Martha O. Hesse and Commissioner Charles G. Stalon).

generation in which utilities, IPPs, and generators which qualify for the PURPA incentives would freely compete to buy and sell electric power.

The FERC's Commissioner Trabandt issued a vigorous and articulate dissent to the NOPRs.⁵ The competitive bidding and IPP proposals would, according to Commissioner Trabandt, radically restructure the electric utility industry.⁶ Despite very strong reservations concerning the legality and practical effects of the NOPRs, Commissioner Trabandt has "partially concurred" with their issuance so that the FERC can turn its attention to other matters.⁷ Commissioner Trabandt accuses the other Commissioners of holding the needed PURPA reforms reflected in the ADFAC proposal hostage to the competitive bidding and IPP initiatives.⁸

While it is too early to predict what form the final rules will take, it seems clear that the FERC is determined to move ahead with the competitive bidding and IPP proposals, despite the reservations of Commissioner Trabandt and others. Comments on the competitive bidding and IPP NOPRs were due on July 15, 1988, and reply comments were due August 15, 1988. Public hearings have been scheduled, and it is anticipated that final rules will be in place by the end of the year.

Questions concerning the legality of the NOPRs are not insubstantial. While it is not possible in the space of this article to present a complete discussion of all problems raised by the NOPRs, the question of whether the NOPRs transcend the FERC's delegated authority under the PURPA and the FPA is a matter that merits close attention at this stage in the FERC's deliberations. That is the purpose of this paper. Furthermore, the question of why the NOPRs should be issued at this point in time is also of paramount concern, and so this paper begins with a review of the PURPA problems that have instigated the issuance of the NOPRs. The review of PURPA problems is followed by a brief review of basic principles of public utility law that constrain the FERC's regulation of the electric utility industry. The ADFAC NOPR is next analyzed in light of the identified PURPA problems and the authority delegated to the FERC by the PURPA. The competitive bidding proposal is then assessed in light of basic principles of public utility law and the FERC's delegated authority and in view of specific precedents. The proposal affecting IPPs is also discussed in light of basic principles of public utility law, delegated authority and applicable precedents. The article concludes with the observation that only the ADFAC proposal is warranted and that the competitive bidding and IPP NOPRs exceed the FERC's authority and intrude into areas that would require action by Congress.

II. THE PURPA PROBLEM IN A NUTSHELL

Section 210 of the PURPA established a federal program to encourage cogeneration and small power production to be implemented jointly by the

5. *Opinion of Commissioner Charles A. Trabandt, Concurring in Part and Dissenting in Part*, IV F.E.R.C. Stats. & Regs. ¶ 32,455, at 32,061 (1988) [hereinafter Trabandt dissent].

6. *Id.* at 32,067.

7. *Id.* at 32,066.

8. *Id.* at 32,070.

FERC and state public utility commissions.⁹ Cogeneration is defined as the production of electric energy plus steam, heat or some other useful form of energy, and a qualifying cogeneration facility (QF) is one that complies with the FERC rules and is owned by a person not primarily engaged in the generation or sale of electric energy.¹⁰ A QF produces less than 80 MW of power from renewable resources (such as hydropower, wind, solar), geothermal, biomass or waste.¹¹ The PURPA requires electric utilities to purchase electric energy and capacity from QFs at the "incremental cost . . . of alternative electric energy" and to sell QFs back-up power.¹² QFs are exempted from state and federal public utility regulatory requirements.¹³ State regulatory commissions and unregulated utilities are required to adopt rules or procedures to implement the requirements that electric utilities buy electric energy and capacity from QFs and provide them back-up power.¹⁴

The FERC implemented the PURPA program in regulations that set out criteria for QFs and for rates at which utilities must buy electric energy from QFs.¹⁵ The QF criteria are self-implementing, meaning that any facility meeting the criteria becomes a QF simply by filing a notice with the FERC.¹⁶ In addition to meeting the statutory criteria, a small power QF must be fueled by waste or renewable resources for seventy-five percent of its energy input,¹⁷ and a cogeneration QF must produce, through "sequential use" of energy, no less than five percent of total output as useful thermal energy.¹⁸ In addition, any cogeneration QF using oil or natural gas as a fuel must satisfy operating efficiency standards.¹⁹

The rules require electric utilities to interconnect with QFs and to pay the full "avoided cost rate" for QF power, unless a state commission determines that a lower rate would be sufficient to encourage cogeneration.²⁰ Avoided cost rates are utility-specific. To determine its avoided cost, a particular utility must file with the appropriate state commission its estimated avoided costs stated annually in 100 MW increments on a cents per kwh basis, taking account of the utility's "plan for the addition of capacity by amount and type,

9. 16 U.S.C. § 824a-3 (1982).

10. *Id.* § 796(18). In this paper, "QF" refers to both qualifying small power and cogeneration facilities.

11. *Id.* § 796(17).

12. *Id.* § 824a-3(a), (b).

13. *Id.* § 824a-3(e). The exemption extends to small power QFs of 30 MW or less and to cogeneration QFs.

14. *Id.* § 824a-3(f).

15. 18 C.F.R. pt. 292 (1988).

16. *Id.* § 292.207(a). The FERC will not look beyond the self-certification in the QF qualification process. *Florida Power & Light Co. v. FERC*, 711 F.2d 219 (D.C. Cir. 1983). Alternatively, a potential QF can submit an application to the FERC under subpart B of the rules for explicit FERC certification of QF status.

17. 18 C.F.R. § 292.204(b) (1988).

18. *Id.* § 292.205(a)(1).

19. *Id.* § 292.205(a)(2).

20. *Id.* § 292.304(a).

for purchase of firm energy and capacity, and for capacity retirements."²¹ Unregulated utilities must make such information publicly available. Through an administrative determination, both an avoided energy cost rate and avoided capacity cost rate can be set for each utility.

The United States Supreme Court upheld the constitutionality of the PURPA in *FERC v. Mississippi*,²² and the FERC's implementing rules were upheld in *American Paper Institute, Inc. v. American Electric Power Service Corp.*²³ In upholding section 210 of the PURPA, the Supreme Court stated, "[i]nsofar as § 210 authorizes FERC to exempt qualified power facilities from 'state laws and regulations,' it does nothing more than preempt conflicting state enactments in the traditional way."²⁴ With respect to the burdens section 210 imposes on utilities and state commissions, the Court upheld the PURPA because "the commerce power permits Congress to preempt the States entirely in the regulation of private utilities."²⁵

The PURPA has been extremely successful in stimulating cogeneration and small power production. In many cases, PURPA capacity has delayed construction of or led to cancellation of coal-fired or nuclear baseload plants. PURPA capacity added nationally in the 1980's amounted to 13,000 to 15,000 MW, while in the same time frame only 4,500 MW of conventional capacity were ordered by investor-owned utilities and 5,000 by publicly owned utilities.²⁶ Since 1980, notices or applications for more than 43,500 MW of QF capacity have been submitted to the FERC.²⁷

The success of the PURPA has led to claims that the electric power generation business has been grossly distorted. Moreover, throughout the country, implementation of the PURPA by state commissions has varied widely.²⁸ In Texas, utilities claim they are swamped with excess capacity from PURPA cogeneration.²⁹ Pacific Gas & Electric Company has argued that enforcement of the PURPA by the California Public Utilities Commission will cost ratepayers over \$1 billion owing to displacement of more efficient utility-owned generation,³⁰ and Southern California Edison claims that PURPA implemen-

21. *Id.* § 292.302(b)(2). The avoided-costs are costs to obtain energy from alternative sources if the purchase from a QF were not made. 16 U.S.C. § 824a-3(a) (1982).

22. *FERC v. Mississippi*, 456 U.S. 742 (1982).

23. *American Paper Inst., Inc. v. American Elec. Power Serv. Corp.*, 461 U.S. 402 (1983).

24. *Mississippi*, 456 U.S. at 759.

25. *Id.* at 764. See also, *American Paper*, 461 U.S. at 406.

26. U.S. DEPT. OF ENERGY, *ENERGY SECURITY: A REPORT TO THE PRESIDENT OF THE UNITED STATES* 157 (1987) [hereinafter *ENERGY SECURITY*].

27. *Id.*

28. See *Consolidated Edison Co. v. Public Serv. Comm'n*, 470 U.S. 1075 (1985) (White, J., dissenting); Lock & Van Kuiken, *Cogeneration and Small Power Production: State Implementation of Section 210 of PURPA*, 3 SOLAR L. REP. 659 (1981).

29. *Petition of Inquiry into the Rates Paid by Houston Lighting and Power Company to Qualifying Facilities for the Purchase of Non-Firm Energy*, 12 TEX. P.U.C. BULL. 795 (1986); *Implementation of the Public Utility Regulatory Policies Act of 1978: Hearings Before the Senate Comm. on Energy and Natural Resources*, 99th Cong., 2d Sess. 15-51 (1986) [hereinafter *1986 Hearings*].

30. *Petition for writ of certiorari to the California Supreme Court was denied. Pacific Gas & Elec. Co. v. Public Utils. Comm'n*, 108 S. Ct. 156 (1987).

tation by the California Commission will cost its ratepayers \$2.5 billion.³¹ New York utilities argue that the PURPA's objective of preserving just and reasonable rates for utility consumers has been undermined by the New York Public Service Commission's establishment of a fixed rate (six cents per kwh) set above avoided costs for purchases from QFs.³²

These and related problems with PURPA implementation have been acknowledged by the FERC and the Department of Energy (DOE). The FERC cites in its ADFAC NOPR to complaints by utilities of overpayment to QFs and capacity payments to QFs when no capacity is needed.³³ The DOE reports that in some states avoided cost rates have included capacity payments when no capacity additions were needed, approval of long-term contracts to buy QF power at rates higher than avoided costs, and over reliance on fossil fueled cogeneration at the expense of non-fossil alternatives.³⁴

Supporters of the PURPA argue, on the other hand, that the PURPA has induced the development of alternative electric generating resources that are being provided in a timely manner and at costs that are just and reasonable, and that even more power could be generated if more long-term contracts were available and wheeling were provided.³⁵ PURPA supporters claim that cogeneration and small power are meeting the capacity needs resulting from utilities' reluctance to invest in major baseload generating resources.³⁶

A. Avoided Cost Rates

The linchpin of the PURPA program to encourage cogeneration and small power production is the avoided cost rate, the determination of which has generated considerable controversy. The PURPA, as implemented by the FERC, *requires* utilities to purchase available power and energy from QFs at rates derived from avoided cost data. Two avoided cost rates are involved: one for energy and one for capacity. While the FERC regulations provide criteria for each, there is no hard and fast rule as to how to set avoided cost rates.

There seems to be general agreement as to avoided energy rates,³⁷ but

31. 1986 *Hearings*, *supra* note 29, at 101-59.

32. Consolidated Edison Co. v. Public Serv. Comm'n, 63 N.Y.2d 424, 472 N.E.2d 981 (1984), *appeal dismissed*, 470 U.S. 1075 (1985). The FERC, in Orange & Rockland Util., Inc., 43 F.E.R.C. ¶ 61,067 (1988), ruled that the New York rate is inconsistent with the PURPA. The FERC explicitly reversed the statement in the preamble to its 1980 PURPA regulations that authorized rates above avoided cost under state law.

33. Notice of Proposed Rulemaking, *Administrative Determination of Full Avoided Costs, Sales of Power to Qualifying Facilities, and Interconnection Facilities*, IV F.E.R.C. Stats. & Regs. ¶ 32,457, at 32,159, 53 Fed. Reg. 9331 (1988) (to be codified at C.F.R. pt. 292) [hereinafter ADFAC NOPR].

34. ENERGY SECURITY, *supra* note 26; *see also* U.S. DEPT. OF ENERGY, COGENERATION; SMALL POWER PRODUCTION (1987) [hereinafter DOE Comments]. A 1987 study by Hagler, Bailly & Company indicates that natural gas accounts for 49% of the capacity of active, announced QF projects. *Questions Seen for U.S. Cogeneration*, OIL & GAS J., Jan. 18, 1988, at 21.

35. 1986 *Hearings*, *supra* note 29, at 170-237, 289-475.

36. *Id.*

37. *See* ADFAC NOPR, *supra* note 33, at 32,163; Order No. 69, *Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, [1977-1981 Regs. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,128, at 30,865, 45 Fed. Reg. 12,214, at

state commissions have devised varying standards to determine avoided capacity costs. Most rely on expert testimony describing hypothetical units, the costs of which are to be avoided.³⁸

Decisions in some states have approved avoided cost rates that are zero if no capacity costs can actually be avoided.³⁹ The preamble to the FERC's rules supports this approach, recognizing that, where a utility has no plans to add capacity, its avoided capacity cost is zero.⁴⁰ The FERC explains that in such a situation no capacity payment is due to a QF, although energy payments must still be made.⁴¹ Some states, however, refuse to recognize this concept and have required utilities to make fixed, capacity payments to QFs.⁴² In those states, and in others where utility-specific capacity payments are set infrequently, QFs can and do displace cheaper or more efficient alternatives.

While a certain amount of diversity among the different states can be tolerated under the PURPA, even basic issues remain unresolved. For example, the Kansas Supreme Court is in direct disagreement with the New York Court of Appeals on the issue of whether state commissions can approve QF power purchase rates in excess of avoided cost.⁴³ Justice White, in dissenting from the Supreme Court's refusal to review the New York Court of Appeals decision, decried the unsettled state of the law on avoided costs and called for Supreme Court guidance.⁴⁴ Justice White, however, was unable to persuade his colleagues to address the problem, and the Supreme Court again declined to take up the issue when Pacific Gas & Electric Company sought review of the PURPA interpretations of the California Commission.⁴⁵

Implementation of the PURPA does not reflect the policy and intention of Congress if it encourages fossil fueled QF capacity over non-fossil alternatives. The fundamental policy behind the PURPA is to reduce dependence on

12,216 (1980) [hereinafter Order No. 69] (avoided energy costs represent the cost of fuel and some operating and maintenance expense); *In re Proceeding Before Michigan Pub. Serv. Comm'n to Implement Title II, Section 210 of the PURPA*, No. U-6798 (Aug. 21, 1984) (excluding hydropower purchases from avoided energy cost calculations). *But see* *Public Serv. Co. v. Public Utils. Comm'n*, 687 P.2d 968 (Colo. 1984) (The Colorado Commission found that avoided capacity and energy costs were the costs of purchased, non-QF hydroelectric generation avoided as a result of QF purchasers. This decision would allow fossil-fueled QFs to displace hydroelectric generation.).

38. See Yokell and Marcus, *Rate-Making for Sales of Power to Electric Utilities*, 114 PUB. UTIL. FORT., Aug. 2, 1984, at 21; Note, *Full-Avoided Cost Pricing Under The Public Utility Regulatory Policies Act: "Just and Reasonable" to Electric Consumers*, 69 CORNELL L. REV. 1267 (1984).

39. See, e.g., *Petition of Inquiry into the Rates Paid by Houston Lighting and Power Company to Qualifying Facilities for the Purchase of Non-Firm Energy*, 12 TEX. P.U.C. BULL. 795 (1986).

40. Order No. 69, *supra* note 37, at 30,885.

41. *Id.*

42. See, e.g., *Consolidated Edison Co. v. Public Serv. Comm'n*, 63 N.Y.2d 424, 472 N.E.2d 981 (1984) *appeal dismissed*, 470 U.S. 1075 (1985). California initially required fixed capacity rates under standard offer contracts (S04). California changed this approach in July of 1986, incorporating a competitive bidding feature. Meade, *Competitive Bidding and the Regulatory Balancing Act*, 120 PUB. UTIL. FORT. 22, Sept. 10, 1987, at 22.

43. *Compare* *Kansas City Power & Light Co. v. State Corp. Comm'n*, 234 Kan. 1052, 676 P.2d 674 (1984) (QF purchase rate must equal and may not exceed full avoided cost) *with* *Consolidated Edison*, 63 N.Y.2d 424 (state can set a fixed QF purchase rate that is higher than full avoided-costs).

44. *Consolidated Edison*, 470 U.S. at 1078.

45. *Pacific Gas & Elec. Co. v. Public Utils. Comm'n*, 108 S. Ct. 156 (1987).

oil and natural gas, and to that end, the Act encourages development of hydroelectric projects, energy projects utilizing renewable resources and waste, and cogeneration. This is apparent from the wording of the statute and is supported by its legislative history, which points to the growing dependence on imported oil as the primary target of the PURPA:

The fundamental problem for U.S. energy policy is the insecurity of its oil supply

. . . .
The United States cannot continue to consume energy as if it had plenty of spare capacity of oil production and could expect further growth in domestic oil supplies

Our reliance on imported oil is expected to increase dramatically if present practices and policies are continued

Such an increase in our reliance on oil imports would greatly constrain our foreign policy and could do considerable damage to our economy.

. . . .
The choice for the United States is evident: We must begin now, while there is still time to make adjustments, to change the way Americans use energy and avoid the disruption that could be suddenly thrust upon us from external sources. . . .⁴⁶

The legislative history explains that the PURPA represents:

an effort to adopt a comprehensive set of policies which will allow the U.S. economy the time to make an orderly transition to an era of expensive energy resources, in particular oil and gas resources, from a past characterized by very inexpensive energy resources [T]he incentives and penalties must be put in place now, with appropriate phase-ins, *to ensure the timely and steady transition away from oil and gas resources, and toward the greater use of coal, uranium, renewable, and other energy resources.*⁴⁷

Given the intent and purpose of the PURPA as expressed in the legislative history, it makes no sense for the PURPA rules to favor oil and gas fueled QFs over generation which does not use oil or gas, such as hydropower, coal or nuclear, unless the QFs are actually cheaper, more efficient sources of power.

In addition to complaints that the PURPA encourages fossil fuel cogenerators, PURPA implementation is under attack for displacing more efficient or cheaper utility generators, and thereby increasing rates for customers of electric utilities that are required to buy QF power. Subsection 210(b) of the PURPA requires that rates at which QF power is purchased be "just and reasonable to the electric consumers of the electric utility" purchasing the QF power.⁴⁸ The FERC has sought to protect utility consumers, first, by requiring that QF purchase rates not exceed avoided costs,⁴⁹ and, second, by allowing utilities to be excused from QF purchases during periods when "purchases from qualifying facilities will result in costs greater than those which the utility would incur if it . . . instead generated an equivalent amount

46. H.R. REP. NO. 543, 95th Cong., 2d Sess. 5-6 (1978).

47. *Id.* at 8 (emphasis added).

48. 16 U.S.C. § 824a-3(b)(1) (1982).

49. 18 C.F.R. § 292.304(b)(2) (1988); *see also* American Paper Inst. Inc. v. American Elec. Power Serv. Corp., 461 U.S. 402, 416 (1983).

of energy itself."⁵⁰ A state can also approve a QF purchase rate at less than full avoided cost if it determines that the lower rate is sufficient to encourage small power production and cogeneration.⁵¹ The PURPA clearly reflects a policy that utility ratepayers not be required to pay more for electric power in order to subsidize QFs.⁵² Implementation by state commissions, at least in some cases, appears to have transgressed this principle.

Avoided cost rate problems are amenable to solutions at the regulatory level without amending the PURPA statute itself. Reform or revision of avoided cost calculation criteria and procedures, or at least policy guidance from the FERC would seem to be warranted. Direct action against state commissions, either by utilities or by the FERC itself, for refusing to follow existing FERC regulations implementing the PURPA is also a useful tool. One such action has been concluded by the FERC. In the *Orange & Rockland* case, the FERC overruled the rate set by the New York Public Service Commission of six cents per kwh as being in excess of full avoided costs and therefore unauthorized by the PURPA.⁵³

B. QF Status and PURPA Machines

There are two basic types of QFs: small power producers and cogenerators. The distinction between the two is important in light of PURPA's intent and purpose. Small power producers produce electrical energy from fuels other than oil and natural gas.⁵⁴ They use renewable resources, such as hydropower, wind, and solar energy. They may also use geothermal, biomass and waste,⁵⁵ the definitions of which have been further refined by the FERC decisions. Small power producers directly reduce reliance on oil and natural gas. Cogeneration facilities, by contrast, are not confined to energy sources encouraged by the PURPA. Rather, they may burn oil and natural gas, but they must also produce useful thermal energy.⁵⁶ The rationale for creating incentives for these cogenerators is one of efficiency. Industries that generate thermal power for industrial processes are encouraged to produce electricity sequentially in the same process.

Qualification as a QF on the basis of a renewable resource fuel has not proved problematic, and applications for QF status have been handled routinely. Geothermal projects up to 80 MW in size were qualified for QF status by a 1980 amendment to the PURPA, which was implemented by the FERC in Order No. 135.⁵⁷ Application of the biomass criterion to wood, wood

50. 18 C.F.R. § 292.304(f)(1) (1988). Advance notification to the appropriate state commission, with the opportunity for review, is required to invoke the cheaper alternative exemption. *Id.* § 292.304(f)(2)-(4).

51. *Id.* § 292.304(b)(3).

52. H. CONF. REP. NO. 1750, 95th Cong., 2d Sess. 97-98 (1978).

53. *Orange & Rockland Utils., Inc.*, 43 F.E.R.C. ¶ 61,067 (1988).

54. A small power producer produces less than 80 MW of power from geothermal, biomass, waste, or renewable resources. 16 U.S.C. § 796(17)(A) (1982). Fossil fuels cannot constitute more than 25% of energy input. 18 C.F.R. § 292.204(b) (1988).

55. Biomass includes any organic material not derived from fossil fuels. 18 C.F.R. § 292.202(a) (1988). Waste is defined as by-product materials other than biomass. *Id.* § 292.202(b).

56. *Id.* §§ 292.202(c), 292.203(b).

57. Order No. 135, *Eligibility, Rates, and Exemptions for Qualifying and Utility-Owned Geothermal*

chips, peat and similar substances has also been routine.

Applicability of the waste criterion has generated a considerable amount of attention, particularly where the "waste" is itself an energy fuel or byproduct of an energy fuel. The FERC has developed an economic test to apply in individual cases that focuses on whether the fuel is a byproduct and has any economic value apart from its potential source as a QF fuel.⁵⁸ Under this test, a fuel qualifies as a waste if it is an unavoidable, incidental product of an industrial operation and the costs of salvage and marketing exceed the costs of disposal.

Under this test, shut-in and flared natural gas do not qualify as waste,⁵⁹ but methane gas from an abandoned coal mine does qualify.⁶⁰ A high-ash lignite residue previously stored as a waste product was qualified as a waste fuel in a specific application of the economic test.⁶¹ A byproduct of coal mining, culm, was held to be a qualifying waste fuel under this standard.⁶²

Systems in which oil and natural gas are not used as primary fuels but provide the medium for extraction of waste energy or allow energy production from renewable resources may also qualify as small power QFs.⁶³ However, the waste or renewable fuel criteria must be met. Thus, for example, inertial energy of an oil well pump does not qualify as "waste" because it is not independent of, or a byproduct of, the oil production process.⁶⁴

Cogeneration facilities present more complicated issues. To qualify as a cogenerator, the facility must produce, through sequential use of energy, both electrical power and useful thermal energy.⁶⁵ If energy is used first to produce electric power (topping cycle) and the facility is fueled by oil or natural gas, the facility must meet an efficiency standard under which the electrical power plus one-half the thermal output are 42.5% of the energy input.⁶⁶ If it produces thermal energy first and electrical energy second (bottoming cycle), then the useful power output must be no less than forty-five percent of energy input.⁶⁷ Unlike small power producers, cogenerator QFs have no size limitation.

In addressing the sequential use criterion, the FERC has approved extraction turbines for industrial steam as QFs, even though all steam provid-

Small Power Production Facilities, [1977-1981 Regs. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,241, 46 Fed. Reg. 19,229 (1981).

58. Kenvil Energy Corp., 23 F.E.R.C. ¶ 61,139 (1983); Tulsa Energy Corp., 19 F.E.R.C. ¶ 61,331 (1982).

59. *Tulsa Energy*, 19 F.E.R.C. at 61,632.

60. Stieren Farms, 17 F.E.R.C. ¶ 61,260 (1981).

61. American Lignite Prods. Co., 25 F.E.R.C. ¶ 61,054 (1983).

62. Electrodyne Research Corp., 32 F.E.R.C. ¶ 61,102 (1985). The ruling on culm was generic in that future applications for culm fuel plants would not have to satisfy the economic value test.

63. Turbo Power Sys., 40 F.E.R.C. ¶ 61,357 (1987); LUZ Solar Partners Ltd., 30 F.E.R.C. ¶ 61,122 (1985).

64. Turbine Tech, Inc., 31 F.E.R.C. ¶ 61,184 (1985).

65. 18 C.F.R. § 292.202(c) (1988).

66. *Id.* §§ 292.202(d), 292.205(a).

67. *Id.* §§ 292.202(e), 292.205(b).

ing the thermal use did not also provide generation.⁶⁸ It was enough that all of the steam providing generation was also put to a thermal use. Concerning the useful thermal application, the FERC has held that, for thermal output to be useful, it must have an independent business purpose with some independent economic justification.⁶⁹ Drying of coal before burning it in the facility does not qualify as an independent thermal use.⁷⁰ In one case, an aquaculture application was found to be a qualified thermal use,⁷¹ notwithstanding that the FERC had disapproved a proposed aquaculture application for an earlier facility.⁷²

The FERC has addressed efficiency standards in response to requests for waivers. In *Mercy Hospital & Medical Center*,⁷³ the FERC denied an efficiency waiver for a topping cycle facility with a 38.8% rating because denial would force the applicant to build a smaller facility. The FERC reasoned that the smaller facility would consume less natural gas than would be saved by the cogeneration features of the proposed facility. In *Nelson Industrial Steam Co.*,⁷⁴ the FERC on rehearing granted a waiver for a proposal to convert two gas-fired, utility-owned power plants to cogeneration facilities, in which steam would be used by a nearby chemical company. The utility was to own only one percent of the QF. The owners proposed to convert the boilers, after five years, to fluidized bed combustion to burn petroleum coke or coal. The FERC granted the waiver of efficiency standards because of the project's local employment benefits, and because of the later-planned use of fluidized bed technology.⁷⁵ The FERC explained that the waiver was needed only for the temporary, five-year period because efficiency standards do not apply if coal or coke is the fuel.

It is the cogeneration QF that has earned the sobriquet "PURPA machine." The FERC reported that some topping cycle plants are designed with a contrived thermal application, such as "a greenhouse tacked on the back," solely to meet the QF criteria of the FERC's regulations.⁷⁶ While these plants make money because of the PURPA rules, they are not optimally efficient investments. The DOE has pointed out that the overwhelming response to the PURPA has produced a major investment in oil and natural gas-fired cogeneration, which is increasing rather than lessening our dependence on precious fluid fuels for the production of electricity.⁷⁷ Such a result is not consistent with the goals of the PURPA.

Problems with "PURPA machines" and efficiency standards are amena-

68. *Texas Indus., Inc.*, 29 F.E.R.C. ¶ 61,051 (1984). It was recently ruled that a proposed QF failed the sequentiality test in *StarMark Energy Sys., Inc.*, 41 F.E.R.C. ¶ 61,175 (1987).

69. *Electrodyne Research Corp.*, 32 F.E.R.C. ¶ 61,102 (1985).

70. *Id.*

71. *John W. Savage*, 28 F.E.R.C. ¶ 61,273 (1984).

72. *EG&G, Inc.*, 16 F.E.R.C. ¶ 61,060 (1981).

73. *Mercy Hosp. & Medical Center*, 18 F.E.R.C. ¶ 61,128 (1982).

74. *Nelson Indus. Steam Co.*, 39 F.E.R.C. ¶ 61,201 (1987).

75. *Id.* at 61,724.

76. *Regulating IPP's*, *supra* note 3, at 36.

77. *ENERGY SECURITY*, *supra* note 26 (40% of QFs are oil or gas-fired cogeneration); DOE Comments, *supra* note 34, at 3-4.

ble to regulatory solutions. Modification of efficiency standards to prevent inefficient investment in cogenerators solely to qualify them as QFs may well be appropriate. Efficiency standards are a creature of the FERC's rules and therefore can be changed by the FERC. Moreover, eight years of experience with the FERC's existing rules have created a body of decisional authority relating to other QF criteria that could be synthesized in new revised rules.

C. Ownership, Retail Sales and Non-Exempt QFs

Issues concerning QF ownership and sales of QF power have arisen under the regulation barring utility ownership of QFs.⁷⁸ *Alcon (Puerto Rico), Inc.*,⁷⁹ reversed an earlier ruling and resolved the issue of third party participation in QF facilities. Notwithstanding that the QF may be owned by an entity separate from the industrial thermal and electric power user, the industrial user is still eligible for supplementary and back-up power from the local utility, at least if there is a close nexus between the QF facility and industrial user.⁸⁰ *Alcon* also addressed the retail sale issue, saying that retail sales by a QF were controlled by state law.⁸¹

The question of what "facilities" are entitled to be considered part of a QF was addressed in *Kern River Cogenerator Co.*,⁸² where the FERC extended QF status and exemptions to include a switchyard owned and operated by the QF for interconnection purposes. In *Clarion Power Co.*, the FERC extended the logic of *Kern River* to include a transmission line owned by a QF and used solely for purposes of selling QF power and for obtaining maintenance and back-up power for the QF.⁸³

In *PRI Energy Systems, Inc.*,⁸⁴ the FERC approved a QF proposal whereby the QF would be owned separately and would sell energy to several separate users. The FERC ruled that it was not barred by the PURPA from approving such a plan, and that the PURPA precludes only the grant of QF status from constituting retail sale authorization. The FERC opined that whether a QF can make retail sales should be resolved in a state forum. A similar result was reached in *Riverbay Corp.*,⁸⁵ where the FERC found that an apartment cooperative was not selling but allocating electricity to its cooperative members.

In *Ultrapower 3*,⁸⁶ the FERC allowed a wholly-owned subsidiary of an electric utility to participate as a fifty percent general partner in a QF,

78. 18 C.F.R. § 292.206 (1988).

79. *Alcon (Puerto Rico), Inc.*, 38 F.E.R.C. ¶ 61,042 (1987), *petition for rev. denied sub nom.* Puerto Rico Elec. Power Auth. v. FERC, 848 F.2d 243 (D.C. Cir. 1988).

80. Commissioner Trabandt tentatively concurred in *Alcon* on the basis of there being a close nexus. *Alcon*, 38 F.E.R.C. ¶ 61,042, at 61,123-24.

81. *Id.* at 61,121 n.8.

82. *Kern River Cogenerator*, 31 F.E.R.C. ¶ 61,183 (1985).

83. *Clarion Power Co.*, 39 F.E.R.C. ¶ 61,317 (1987).

84. *PRI Energy Systems, Inc.*, 26 F.E.R.C. ¶ 61,177 (1984).

85. *Riverbay Corp.*, 25 F.E.R.C. ¶ 61,316 (1983).

86. *Ultrapower 3*, 27 F.E.R.C. ¶ 61,094 (1984); *but see* *Prodek/Hydro Resources Joint Venture*, 41 F.E.R.C. ¶ 61,152 (1987) (refusing to extend *Ultrapower 3* to situations where profits and losses were not equally shared).

notwithstanding that its initial capital contribution was twice that of the non-utility partner. Under California law, the utility subsidiary was a fifty percent general partner because profits and losses were shared on a fifty-fifty basis. The FERC therefore concluded that a utility did not own more than a fifty percent equity interest and that its participation consequently was not barred by 18 C.F.R. § 292.206.

Under the PURPA, exemption of QFs from state and federal utility regulation extends only to small power producers of less than 30 MW. (Cogenerators are not subject to the same limitation.) Those between 30 and 80 MW are still subject to the FERC's regulation under the FPA because they are selling electric power for resale in interstate commerce. In addressing this class of QFs in *Resources Recovery (Dade County), Inc.*,⁸⁷ the FERC, citing the legislative history of the PURPA, has stated it will approve as just and reasonable a rate not in excess of the purchasing utility's incremental cost of alternative energy.⁸⁸ The FERC granted to Resources Recovery (Dade County) (RRD) a waiver of part 35 of the FERC's cost-of-service filing requirements, allowing the 76 MW QF to file instead the buying utility's avoided-cost rate as set by the state public service commission.⁸⁹ The FERC approved the avoided-cost rate as the just and reasonable rate for the QF. Subsequently, the FERC also exempted RRD from the FERC's uniform system of accounts and certain reporting regulations.⁹⁰ Because these regulations are designed to facilitate cost-of-service ratemaking, which is inapplicable to QFs, the FERC waived the regulations.⁹¹

RRD also sought waiver and blanket authorizations under regulations respecting property dispositions and consolidations, securities and holding of interlocking positions. The FERC had a more difficult time with these because sections 203, 204 and 305 of the FPA, under which these regulations were adopted, do not authorize waivers or exemptions. The FERC, noting the intent of Congress to encourage QFs, waived the full filing requirements of the regulations and assessment of annual charges but not the statutory requirements. Hence, RRD must seek prior FERC approval, by filing notice and allowing opportunity for a hearing, of property dispositions and issuance or acquisition of securities, and must file an abbreviated notice respecting interlocking positions.⁹²

Finally, the question of the obligations of a purchasing utility to provide back-up power were addressed in *Oglethorpe Power Corp.*,⁹³ a case that granted certain waivers to a rural electric cooperative. The FERC explained

87. *Resources Recovery (Dade Co.), Inc.*, 18 F.E.R.C. ¶ 61,243 (1982), *aff'd sub. nom.* *Florida Power & Light Co. v. FERC*, 711 F.2d 219 (D.C. Cir. 1983).

88. *Id.*

89. *Id.* The FERC waived 18 C.F.R. pt. 35 (1988).

90. *Resources Recovery (Dade Co.), Inc.*, 20 F.E.R.C. ¶ 61,138 (1982).

91. *Id.* The FERC waived 18 C.F.R. pts. 41, 50, 101 & 141 (1988).

92. *Resources Recovery*, 20 F.E.R.C. at 61,302-04. A purchase transaction by RRD under the abbreviated notice procedure was subsequently approved in a *pro forma* FERC order. *Resources Recovery (Dade Co.), Inc.*, 25 F.E.R.C. ¶ 62,191 (1983).

93. *Oglethorpe Power Corp.*, 35 F.E.R.C. ¶ 61,069 (1986), *aff'd sub nom.* *Greensboro Lumber Co. v. FERC*, 825 F.2d 518 (D.C. Cir. 1987).

that all four types of power described in its regulations—back-up, supplementary, maintenance, and interruptible—must be provided on request of a QF, and that one type of service cannot serve as a substitute for another.⁹⁴

D. Summary of PURPA Problems

The PURPA regulations are ripe for reform. Application of the avoided-cost rules and QF criteria appear to be frustrating, at least to some extent, the primary purpose of the PURPA, which is to reduce reliance on oil and natural gas. It also appears that, to some extent, inefficient generating plants are being favored, producing rates for utility customers that may not be just and reasonable. Continued assurance of safe, adequate and reliable utility service at the lowest possible reasonable cost may well be affected, at least in some areas.

Radical adjustments to the PURPA rules are probably not warranted. The positive response to section 210 of the PURPA was clearly not anticipated. The PURPA has proven to be very successful in inducing alternative generating resources at a time when utilities have been reluctant to invest in such resources. There appears to be a general consensus in the electric utility industry that PURPA problems are problems of implementation, and that they could be solved with "fine-tuning" of the regulations.⁹⁵

The PURPA has provided experience with limited deregulation. In addition to bringing a degree of competition to the generating segment of the industry, the PURPA has created examples of exemption and waiver of specific regulations and utility participation with non-utility entrepreneurs. These lessons should be applied as the FERC considers deregulation of other segments of the utility industry.

III. BASIC PRINCIPLES OF ELECTRIC UTILITY LAW

Long before the enactment of the FPA, the Supreme Court laid down basic principles of utility regulation to protect consumers from monopolistic practices, to prevent discriminatory pricing of utility services, to enforce the obligation to provide service at just and reasonable rates, and to insure that utilities were allowed an opportunity to recover prudently incurred costs and a reasonable return on their investment.⁹⁶ These principles have been applied in cases defining what it means to be a public utility and have given substance to the terms "public service" and "public interest." The basic principle recognizes that public utilities are quasi-public entities, entrusted with providing essential public services for which they are granted legal monopolies. In

94. *Id.* at 61,137-38. The FERC ruled that back-up and maintenance power would have to be offered on an interruptible, as well as a firm basis.

95. ADFAC NOPR, *supra* note 33, at 32,158.

96. *E.g.*, *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923); *Western Union Tel. Co. v. Call Publishing Co.*, 181 U.S. 92 (1901); *Smyth v. Ames*, 169 U.S. 466 (1898); *Munn v. Illinois*, 94 U.S. 113 (1876). In fact, as noted by commentators, basic principles of public utility law predate the founding of this country and have remained unchanged for hundreds of years. Norton & Spivak, *The Wholesale Service Obligation of Electric Utilities*, 6 ENERGY L.J. 179, 180-81 (1985); Mogel & Gregg, *Appropriateness of Imposing Common Carrier Status on Interstate Natural Gas Pipe Lines*, 4 ENERGY L.J. 155, 163-67 (1983).

exchange for receiving a monopoly, a public utility is obligated to provide universal service and must be subject to rate regulation to protect against exploitation.

Part II of the FPA,⁹⁷ which was enacted in 1935,⁹⁸ incorporates basic principles of public utility regulation. The regulatory authority conferred by part II of the FPA is limited to interstate sales for resale and interstate transmission, and hence it leaves retail regulation essentially unaffected.⁹⁹ By incorporating the principle of "just and reasonable rates," the FPA adopted the concept of cost-based ratemaking recognized in prior Supreme Court cases.¹⁰⁰ The Supreme Court has also held that the Commission is entrusted with a broad public interest mandate and stands as the first line of defense against anticompetitive and monopolistic practices.¹⁰¹ The FPA embraces the principle of non-discrimination, and reflects as its primary purpose the protection of the public from exploitation at the hands of economically powerful interstate utilities.¹⁰² As construed by the courts, the goal of part II of the FPA is to assure the provision of safe, adequate, and reliable power at the lowest reasonable cost.¹⁰³

The PURPA supplemented the FPA but did not directly change the regulation of interstate utilities or the basic principles applied in their regulation.¹⁰⁴ In fact, state regulation of retail utility service, not wholesale regulation, was the primary target of the PURPA.¹⁰⁵ Like the Natural Gas Policy Act of 1978 (NGPA),¹⁰⁶ passed in the same session of Congress, the PURPA allows some deregulation of energy production while leaving intact

97. 16 U.S.C. §§ 791a-824i (1982).

98. Title II of the Public Utility Act of 1935, Pub. L. No. 74-333, 49 Stat. 838 (1935), redesignated the Federal Water Power Act of 1920 as part I of the FPA and enacted parts II and III of the FPA. Title I of the 1935 Act, Pub. L. No. 74-333, 49 Stat. 803 (1935), enacted the Public Utility Holding Company Act.

99. 16 U.S.C. §§ 824, 824d (1982). The void in regulation left by Public Utils. Comm'n v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927), was the immediate impetus for enactment of part II of the FPA, and Congress intended to leave state retail regulation otherwise unaffected. *First Iowa Hydro-Elec. Coop. v. FPC*, 328 U.S. 152, 171 (1946); *see also* S. REP. NO. 621, 74TH CONG., 1ST SESS. 18 (1935); H.R. REP. NO. 1318, 74th Cong., 1st Sess. 8 (1935). Recently, the supposed "bright line" delineating state and federal regulatory jurisdiction has been blurred by rulings respecting the FERC's jurisdiction over investment and allocation decisions of multi-state, integrated utility systems. *See* *Mississippi Power & Light Co. v. Mississippi*, 108 S. Ct. 2428 (1988); *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986); *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983).

100. *See* *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942) (construing nearly identical provisions of the Natural Gas Act).

101. *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 758-60 (1973).

102. *FPC v. Conway Corp.*, 426 U.S. 271 (1976); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956); *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952); *Municipal Light Bds. v. FPC*, 450 F.2d 1341, 1348 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 989 (1972). *See also* *Atlantic Refining Co. v. Public Serv. Comm'n*, 360 U.S. 378, 388 (1959); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610-12 (1944).

103. The just and reasonable rate need not be the lowest reasonable rate, but it must fall within a range of reasonableness bounded on the low end by interests of utility shareholders and on the high end by consumer interests. *Hope Natural Gas*, 320 U.S. at 591.

104. *See* Opinion No. 246, Middle South Servs., Inc., 33 F.E.R.C. ¶ 61,408 (1985).

105. *Id.* at 61,788-90.

106. 15 U.S.C. §§ 3301-3432 (1982).

the regulation of transmission and distribution.¹⁰⁷

The FERC's recent efforts to restructure the natural gas industry utilizing authority under the NGPA have repeatedly run afoul of the basic principles of utility law enshrined in the Natural Gas Act (NGA).¹⁰⁸ Almost every major regulatory initiative has either been reversed or returned to the FERC by the reviewing courts.¹⁰⁹ For example, the *Maryland People's Counsel* cases¹¹⁰ threw out the FERC's special marketing and temporary transportation programs as being discriminatory against core customers of the gas pipelines. The court found that the FERC had neglected its prime constituency, the retail customers, who the NGA was designed to protect, because the special marketing and transportation programs were not available to those customers. Market-based, economic efficiency arguments were not sufficient to justify the programs. In *Office of Consumers' Counsel v. FERC*,¹¹¹ it was held that the Commission failed to provide a remedy for imprudent gas purchases in its interpretation and application of section 601 of the Natural Gas Policy Act. The court reasoned that excessive payments, even if not arising to the level of fraud and abuse, have a direct impact on consumers that must be remedied. In *Associated Gas Distributors v. FERC*,¹¹² the FERC's Order No. 436 open-access transportation program¹¹³ was approved in part but remanded to the FERC for its failure to address the take-or-pay problem faced by interstate pipelines. Again, the FERC was accused of ignoring its prime constituency, the consumers.¹¹⁴ The Commission's liberalized abandonment policy was remanded in *Consolidated Edison Co. v. FERC* for failure of the FERC to protect the public interest.¹¹⁵

In all of these cases, the FERC made arguments based on economic efficiency and application of market forces while the court found a failure on the

107. QFs, which might otherwise be subject to the FERC's regulation as utilities selling power at wholesale, are exempt from state and the FERC's regulation.

108. The NGA, 15 U.S.C. §§ 717-717w (1982), was passed in the same era as the FPA and contains substantially the same regulatory standards. The Supreme Court applies decisions under one Act as precedent for issues arising under the other. *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981); *FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 211-12 (1964); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956).

109. A notable exception is Order No. 380, which passed judicial muster in *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied sub nom.* *ANR Pipeline Co. v. FERC*, 476 U.S. 1114 (1986).

110. *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) (MPC I); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (MPC II).

111. *Office of Consumers' Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986).

112. *Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 108 S. Ct. 1468 (1988).

113. Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [1982-1985 Regs. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,665 (1987), 18 C.F.R. § 284.9 (1988). On remand, the open-access transportation program was reinstituted with modifications in Order No. 500, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, III F.E.R.C. Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987) (to be codified at C.F.R. pts. 2, 284), *modified*, Order No. 500-A, 41 F.E.R.C. ¶ 61,013 (1987), and Order No. 500-B, 41 F.E.R.C. ¶ 61,024 (1987), Order No. 500-C, 41 F.E.R.C. ¶ 61,351 (1987), and Order No. 500-D 42 F.E.R.C. ¶ 61,302 (1988).

114. *Associated Gas*, 824 F.2d at 1025.

115. *Consolidated Edison Co. v. FERC*, 823 F.2d 630 (D.C. Cir. 1987).

FERC's part to heed the consumer protection mandates of the underlying legislation. This record is hardly auspicious for the FERC's announced intention to restructure the electric industry in order to foster greater economic efficiency.¹¹⁶ Moreover, it is chaotic for industry to adjust to the new FERC rules, adjust again when a court reverses or remands the rules, and then be faced with even further changes and adjustments as the agency tries to comply with court mandates. Such gyrations have resulted from the FERC's efforts to restructure the natural gas industry, an industry which is still highly unsettled from regulatory initiatives begun several years ago.

The initiatives embodied in the electric NOPRs, if enacted in their present form, may well follow the pattern of those in the gas area. For example, the NOPRs do not address the question of access to transmission. Considering the similarity between gas transportation and electric transmission, this could be a fatal mistake. Access to transportation was a crucial stumbling block for the FERC's early spot gas programs, and the FERC's requirement of open-access transportation was one aspect of the Order No. 436 program to receive court approval. But even more basic concepts may prove to be detrimental. Commissioner Stalon insisted in his testimony to the House Subcommittee on Energy and Power that economic efficiency is the goal of all regulatory policy, a view in which Chairman Hesse apparently concurred.¹¹⁷ The goal of greater economic efficiency espoused by both Commissioners, while laudatory, has traditionally taken second place to notions of public interest and public service when the courts review actions of the FERC. The essential question posed by the electric NOPRs is whether they are consistent with the basic principles of public utility law embodied in the Federal Power Act as modified by the PURPA, an issue to which this paper now turns.

IV. THE FERC'S REGULATORY PROPOSALS

Chairman Martha O. Hesse made a speech to the Edison Electric Institute on June 10, 1987, in which she indicated that the wide-scale development of QF power may signal that it is time for the FERC to revise its current regulations.¹¹⁸ Chairman Hesse discussed the possibility of competitive bidding for electric generating capacity that would include QFs, utilities and IPPs as a possible alternative to administratively determined avoided cost rates. Chairman Hesse indicated that if the FERC pursued this issue, competitive bidding would not be mandatory but would be a voluntary option for states under the PURPA.

Respecting IPPs, the Chairman indicated that traditional FERC regula-

116. The FERC's promulgation of a new construction work in progress (CWIP) rule to aid electric utilities was remanded for failure of the FERC to address price squeeze claims. *Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327 (D.C. Cir. 1985).

117. *Hearings on Cogeneration and the Public Utility Regulatory Policies Act of 1978 Before the Subcomm. on Energy and Power, House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 2-3, 5 (1987) (prepared testimony of the FERC's Chairman Martha O. Hesse and Commissioner Charles G. Stalon).

118. FERC News Release, *supra* note 3.

tion may be inappropriate for IPPs that lack monopoly power.¹¹⁹ She suggested that the FERC might consider competitive pricing to be just and reasonable where competitive markets exist. The Chairman also suggested that efficiency standards be considered for participants in competitive bidding, that operating standards for cogenerators and utility participation in QFs be reviewed, and that an analysis of electric transmission issues be made.¹²⁰

The Chairman's speech was not made in a vacuum. The FERC at the time had two major rulemaking proceedings in which such issues had been raised: the electric industry notice of inquiry (NOI) and the proposed changes to the PURPA rules.

The FERC initiated a major NOI in June of 1985.¹²¹ The objective of the FERC's inquiry was "to evaluate its present policies toward wholesale electricity transactions and transmission service," and specifically "how its policies promote, or whether they impede, efficiency in electricity markets and to determine whether there are available alternatives"¹²² In Phase I of this inquiry, the FERC sought comments on coordination and transmission services. For coordination services (interchange transactions and economy energy sales), the FERC indicated it was considering allowing any negotiated or market-determined rate, or a market rate with a ceiling based on the selling utility's "decremental costs," and reapportioning the revenue and costs of such sales as between the ratepayers and stockholders of the participating utilities.¹²³ With respect to transmission, the FERC noted that "[a]vailability of transmission services is a necessary element to competitive electricity markets," and that availability is influenced by the supply of transmission facilities, price and institutional access arrangements.¹²⁴ The FERC observed it had limited authority to order access to transmission and indicated that requests for transmission may have to be evaluated on a case-by-case basis.¹²⁵ Comments on all issues relevant to this inquiry were sought.

In phase II of the NOI, the FERC sought comments on wholesale requirements service, defined as long-term firm supply of capacity and energy to meet all or part of the buyer's loads.¹²⁶ The FERC noted the similarity between wholesale requirements service and retail service from the perspective of the selling utility. The FERC interpreted the just and reasonable mandate of the FPA as requiring that the FERC promote the greatest possible degree of economic efficiency, defined by the FERC as allocating and using resources in a way that most benefits society.¹²⁷ This requires that production and delivery should occur at minimum cost and that resources should be allocated

119. *Id.*

120. *Id.*

121. Notice of Inquiry, *Regulation of Electricity Sales-for-Resale and Transmission Service (Phase I)*, IV F.E.R.C. Stats. & Regs. ¶ 35,518, 50 Fed. Reg. 23,445 (1985).

122. *Id.* at 23,445.

123. *Id.* at 23,446-48.

124. *Id.* at 23,449 (emphasis added).

125. *Id.*

126. Notice of Inquiry, *Regulation of Electricity Sales-for-Resale and Transmission Service (Phase II)*, IV F.E.R.C. Stats. & Regs. ¶ 35,519, 50 Fed. Reg. 27,604 (1985).

127. *Id.*

where they have the highest value.¹²⁸ The FERC pointed to title I of the PURPA, which requires state utility commissions to consider marginal cost pricing, as indicating that the FERC should reconsider its traditional average embedded cost-of-service approach.¹²⁹ The FERC, noting that its regulations allow pricing flexibility, questioned whether its traditional approach should not be fully reassessed, just as states were required to reassess regulatory policies under the PURPA. The FERC requested comments on marginal cost pricing, including its effects on price squeeze, on rate design issues, on timing of capital recovery, and on risk allocation.

Thus launched, the FERC's NOI generated volumes of comments and several conferences. But the FERC has taken no action in this matter since 1985. The FERC has issued no analyses, summaries, or overviews of the record compiled in this docket.¹³⁰ No policy statements or proposed rules have emerged from this initiative.

On January 20, 1987, the FERC launched a series of regional conferences to entertain comments on the implementation of the PURPA. The FERC asked parties to comment on the avoided cost rule, implementation of the PURPA by state commissions, QF qualification criteria and access of QFs to transmission.¹³¹ Regional conferences were held in San Francisco, New Orleans, Boston and Washington, D.C. in March and April of 1987. Chairman Hesse referred to comments received at these conferences in her June 10, 1987 speech to the Edison Electric Institute, and the FERC has relied on input from the conferences in developing its proposals to implement the Chairman's competitive bidding and IPP proposals.

On September 11, 1987, the FERC released a background paper detailing the proposals put forth by Chairman Hesse in her speech of June 10, 1987.¹³² The staff stated that five separate rulemakings were under development: one each for competitive bidding, IPPs and the avoided cost rule, and two rulemakings on other aspects of the QF program. The staff paper detailed aspects of a competitive bidding program and summarily described the other four potential rulemakings. From the staff paper, it appeared that the FERC intended to move forward first with the competitive bidding and IPP rulemakings, leaving avoided cost rate and other PURPA changes for later.

On September 25, 1987, the FERC issued notice of a technical conference on the regulation of IPPs.¹³³ The notice lists five major topic areas, including the need for new policies toward IPPs, identifying and regulating producers lacking market power, rate regulation of IPPs and FERC/state issues. A technical conference was held at the FERC in Washington, D.C. on October 23, 1987. Beforehand, the FERC issued a working paper on IPP regulation

128. *Id.*

129. *Id.* at 27,605.

130. Trabandt dissent, *supra* note 5, at 32,086.

131. Notice of Public Conferences and Request for Comments, *Cogeneration; Small Power Production*, IV F.E.R.C. Stats. & Regs. ¶ 35,011, 52 Fed. Reg. 2552 (1987).

132. Summary of Current Staff Proposals, *supra* note 3. The paper contains a disclaimer, indicating that it does not reflect the position of the FERC.

133. Notice of Technical Conference, *Regulation of Independent Power Producers; Technical Conference*, 52 Fed. Reg. 36,998 (1987).

that proposed broad deregulation of IPPs.¹³⁴

Thus, the March 16, 1988 NOPRs have been preceded by a considerable amount of regulatory activity that has provided opportunities for public review and comment on various aspects of the matters addressed in the three NOPRs. The FERC will undoubtedly argue that these proceedings, while perhaps irregular or disjointed, have afforded rudimentary due process and have created a record upon which to rest its regulatory proposals.¹³⁵ We turn next to consideration of the specifics of each NOPR.

A. *Administrative Determination of Avoided Cost Rates*

The ADFAC NOPR would address many of the major problems in the determination of avoided cost rates. States would have the option of using the new ADFAC procedures or using competitive bidding to set rates for purchases from QFs.¹³⁶ The ADFAC NOPR first reviewed problems that were brought to light in the FERC's regional PURPA conferences, and then provided the FERC's assessment and the proposed modifications to its regulations.

1. *Avoided Cost Standard*

The NOPR reaffirmed the avoided cost standard as the best means to achieve the three essential criteria of section 210 of the PURPA for purchases from QFs: (1) rates must be just and reasonable to consumers of the purchasing utility and in the public interest; (2) rates must be non-discriminatory with respect to QFs; and (3) rates must not be in excess of the incremental cost of alternative electric energy.¹³⁷ The FERC explained that QF purchase rates should be at the full avoided cost rate, neither above it nor below it.¹³⁸ The NOPR would amend the existing rule to provide explicitly that states cannot, under the FERC's regulations, set a QF purchase rate above full avoided cost.¹³⁹

With respect to setting avoided cost rates, the FERC explicitly acknowledged that the avoided capacity cost is zero if the purchasing utility cannot

134. *Regulating IPPs*, *supra* note 3. The paper states that it does not necessarily reflect the views of the FERC.

135. The FERC cites to the 1985 NOI, its regional hearings in 1987, its technical conference in 1987, and 1986 Congressional hearings as establishing the procedural background for its NOPRs. ADFAC NOPR, *supra* note 33, at 32,158; Notice of Proposed Rulemaking, *Regulating Government Bidding Programs*, IV F.E.R.C. Stats. & Regs. ¶ 32,455, at 32,024, 53 Fed. Reg. 9324 (1988) [hereinafter Competitive Bidding NOPR]; Notice of Proposed Rulemaking, *Regulations Governing Independent Power Producers*, IV F.E.R.C. Stats. & Regs. ¶ 34,456, at 32,104, 53 Fed. Reg. 9327 (1988) [hereinafter IPP NOPR].

136. ADFAC NOPR, *supra* note 33, at 32,167.

137. *Id.* at 32,157, 32,163.

138. *Id.* at 32,163.

139. 18 C.F.R. § 292.304(a)(2) (1988); *see also* 53 Fed. Reg. 9331, at 9332 (1988). This aspect of the regulation would incorporate Orange & Rockland Utils., Inc., 43 F.E.R.C. ¶ 61,067 (1988), as part of the FERC's rules. In light of the Supreme Court's ruling in *FERC v. Mississippi*, 456 U.S. 742 (1982), regarding the preemptive effect of the PURPA, the FERC's proposed rule is probably legally valid.

avoid capacity or has excess capacity as a result of QF purchases.¹⁴⁰ The FERC further acknowledged that avoided energy costs can be zero or even negative if, for example, baseload generation must be shut down in order to accommodate QF energy purchases.¹⁴¹ Where avoided costs are zero, the rate for QF purchases would be zero and there would be no such purchases required.¹⁴² The FERC proposed amendments to section 292.304(c)(3) to prevent the use of standard rates in violation of this principle.¹⁴³

The FERC's prior approach to determining avoided costs under general guidelines has been reaffirmed in the NOPR with some additional guidance. The FERC advised that qualitative characteristics (i.e., peaking or baseload) must be taken into account in setting avoided cost rates so that QF purchases match the purchasing utility's actual needs.¹⁴⁴ The FERC stated that avoided cost rates must reflect the characteristics of the utility's expansion plans, not its last unit or an entirely hypothetical unit.¹⁴⁵ Changes to proposed sections 292.304(b)(6) and 292.304(e)(3) would make this explicit. On the other hand, the cost of the unit avoided must reflect all alternative sources, including wholesale purchases, that are available to the purchasing utility.¹⁴⁶ The FERC proposed changing the existing rules by more clearly defining the factors to be considered, requiring a written explanation, and deleting the "to the extent practicable" language of the original rules.¹⁴⁷ The proposed revisions also would encourage redetermination of avoided costs when the amount of offered QF capacity is excessive.¹⁴⁸

2. Fuel Diversity

Concerning complaints that QF purchases can increase a utility's reliance on a single fuel source (i.e., natural gas), the FERC has proposed changes that will allow fuel diversity to be taken into account in setting avoided cost rates.¹⁴⁹ In addition, so that capital intensive baseload plants (i.e., large coal, nuclear or hydroelectric plants) are not unjustifiably discouraged, the FERC advised that plant life cycle costs be used in determining avoided costs.¹⁵⁰ The FERC, however, left implementation of any fuels preference policy entirely to state discretion. There is no attempt in the NOPR, for example, to change the efficiency standards for QFs. In fact, allowance of competitive bidding as an alternative means to determine avoided costs may, as noted below, increase reliance on oil and natural gas.

140. ADFAC NOPR, *supra* note 33, at 32,159.

141. *Id.* at 32,157.

142. *Id.* at 32,169.

143. *Id.*; *see also* 53 Fed. Reg. 9331, 9332-33 (1988).

144. ADFAC NOPR, *supra* note 33, at 32,165-66.

145. *Id.*

146. *Id.* at 32,166-67.

147. ADFAC NOPR, *supra* note 33, at 32,168. Standard rates must be established for QFs of 1MW or less. 18 C.F.R. § 304(c) (1988).

148. *Id.* at 32,170.

149. *Id.*

150. ADFAC NOPR, *supra* note 33, at 32,169.

3. Long-Term Contracts

The FERC addressed long-term QF purchase contracts, noting that they produce problems of operating efficiency and intergenerational inequity. While long-term contracts may be required for QF financing, they can produce inefficiencies if the QF cannot be dispatched by the utility, and they may, through levelized payments, require ratepayers to subsidize the QFs with rates above avoided costs in the early years of the contract.¹⁵¹ The FERC's proposed amendments, however, stop short of limiting the duration of contracts or requiring flexible contract terms. The proposed rules would explicitly authorize long-term contracts with levelized payments if they are based on estimates of avoided costs over the term of the contract and do not exceed total avoided costs.¹⁵²

4. Multi-Jurisdictional Utilities

Concerning the issue of large utilities or utility-holding companies operating in more than one state, the FERC acknowledged the argument that the utility or system may have only one systemwide avoided cost, but that different states might set different QF purchase rates or make differing interpretations of avoided costs. Rather than proposing rules on this issue, the FERC has solicited comments on it.¹⁵³

5. Supplementary and Back-Up Power

The FERC has proposed rule changes to clarify the obligation of purchasing utilities to supply back-up, supplementary, maintenance and interruptible power to QFs. New regulations would more clearly define those services.¹⁵⁴ Citing the *Oglethorpe* case, the FERC stated that all of these categories of services must be provided on request, even if the purchasing utility does not normally provide them to its other customers.¹⁵⁵ Only a determination that provision of such services would impair the utility's ability safely to serve other customers can obviate the requirement.

With reference to issues raised in the *Alcon* case, the FERC observed that back-up services must be provided to the load served by the QF and not just to the QF itself.¹⁵⁶ Concerning the rates for supplementary and back-up services, the FERC opined that rates should be set under the same principles as rates for other retail services and should properly reflect and recover the costs of the supplementary, back-up or interruptible service.¹⁵⁷ However, the FERC did not venture too far into this area, perhaps in deference to state jurisdictional concerns, and instead called for comments on a list of issues concerning rates.¹⁵⁸ The FERC also left to the states issues related to interconnection

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

152. 18 C.F.R. § 292.304(b)(5) (1988).

153. ADFAC NOPR, *supra* note 33, at 32,174-76.

154. 18 C.F.R. § 292.101(b)(8)-(11) (1988).

155. 18 C.F.R. § 292.305(b) (1988); ADFAC NOPR, *supra* note 33, at 32,177.

156. 18 C.F.R. § 292.305(c) (1988); ADFAC NOPR, *supra* note 33, at 32,178.

157. ADFAC NOPR, *supra* note 33, at 32,178-79.

158. *Id.*

requirements and costs of interconnection when the purchasing utility provides the interconnection.¹⁵⁹

The FERC proposed new rules, however, to allow QFs to build or own, as part of the QF, interconnection facilities and transmission lines. By virtue of owning such facilities, the FERC acknowledged that QFs could arguably become subject to FPA jurisdiction.¹⁶⁰ However, the FERC construed its PURPA authority as sufficient to include such facilities as part of the QF, thereby exempting them from FPA jurisdiction, if they are used to transmit energy between a purchasing utility and the QF.¹⁶¹ The FERC did not rule out that QFs might make retail or wholesale sales to persons other than the purchasing utility, or that the facilities might be used for other than transmitting energy between the QF and the purchasing utility. On issues raised by these possibilities, the FERC sought comments.

6. Summary of the ADFAC Proposal

The ADFAC NOPR appropriately focuses on the PURPA implementation problems that have been identified in the FERC's public hearings and in Congressional hearings. With the possible exception of the extension of QF status to interconnection and transmission facilities (section 292.306(c)), there seems to be no legitimate question as to the FERC's authority to adopt the proposed rules. Moreover, even with respect to QF ownership of such facilities, the form of the final rule is open to question, and there has been no explicit proposal at this time to include a QF exemption for entities that own interconnection and transmission facilities and provide retail or wholesale service.

The ADFAC proposal would solve some major PURPA problems. Together with the *Orange & Rockland* ruling, for example, it should cure the worst problems of the avoided cost rate determination. It does nothing, however, to discourage PURPA machines, apart from relying on competitive bidding to reduce the incentive for such abuses.¹⁶² If states elect not to adopt competitive bidding or if it is ruled illegal, there is no proposed remedy for discouraging the PURPA machines. Despite its shortcomings, the proposed rule would adopt many needed reforms. The NOPR, or some form of it, should be adopted.

B. Competitive Bidding

Competitive bidding refers to the sale of electric power at deregulated prices.¹⁶³ Such a sale would theoretically involve several sellers competing with each other to market an electric power commodity to a public utility.

159. *Id.* at 32,180.

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

161. 18 C.F.R. § 292.305(c) (1988).

162. In a separate notice of proposed rulemaking, which is not discussed in this paper, the FERC has addressed the PURPA—machine issue, certification of QF status, and utility ownership of QFs. Notice of Proposed Rulemaking, *Regulations Governing the Public Utility Policies Act of 1978*, IV F.E.R.C. Stats. & Regs. ¶ 32,465, 53 Fed. Reg. 31,021 (1988).

163. Competitive Bidding NOPR, *supra* note 135, at 32,021.

The rationale for the proposal is that competition, rather than regulation, would prevent a seller from dictating the price to be paid, and competition would select the most efficient generating resource at the lowest reasonable cost.

1. Precedents

Competitive bidding is not entirely unprecedented in the wholesale electric utility industry. As the FERC observed in its NOI, coordination transactions have been regulated without resort to the traditional cost-of-service approach. In some cases involving settlements, the FERC has allowed market-based pricing within a range of rates or with a specific price cap.¹⁶⁴

The FERC has authorized three major experiments involving competitive pricing of bulk power that do away with the prior notice, filing and data submission requirements usually applicable to rate changes. Opinion No. 203¹⁶⁵ authorized a two-year experiment, whereby four investor-owned utilities operating in a three-state area were allowed to buy and sell two electrical commodities—economy energy and block energy—at market-based (unregulated) prices over a range of prices approved by the FERC. The minimum price was the incremental variable cost and the maximum was twice the allocated embedded cost. The selling utilities were required to flow through seventy-five percent of revenues to ratepayers while retaining twenty-five percent for stockholders. Participating utilities agreed to provide each other open-access transmission service for the two commodities during the experiment. The FERC relied on the open-access feature as insuring that a competitive market would be created.¹⁶⁶ Pre-approved termination of the experiment, including all wheeling obligations, was granted by the FERC. The FERC noted regretfully that no QFs were going to participate in the experiment, and the FERC promised to modify the experiment if QFs complained of unfair treatment.¹⁶⁷

In *Pacific Gas & Electric Co.*,¹⁶⁸ an experimental competitive pricing program for the Western Systems Power Pool (WSPP) was authorized. In that opinion, the FERC described the results of the Opinion No. 203 experiment as “mixed.” The Rand Corporation, which did a study on the experiment, found that it improved competition but not efficiency.¹⁶⁹ The FERC claimed that additional experiments were warranted to test its theories, as expressed in the NOI, about competition, decontrol and efficiencies.

In comparison with the Opinion No. 203 experiment, the WSPP experiment involved an entire region (eight investor-owned utilities, six public or cooperative entities, eleven million customers and twelve percent of the nation’s generating capacity) rather than merely a submarket. Transmission and wheeling were strictly voluntary rather than mandatory.¹⁷⁰ The WSPP

164. 50 Fed. Reg. 23,445, at 23,446 (1985).

165. Opinion No. 203, Public Serv. Co. of N.M., 25 F.E.R.C. ¶ 61,469 (1983).

166. *Id.* at 62,037-38.

167. *Id.* at 62,070-73. Participants included several public power entities and investor-owned utilities.

168. *Pacific Gas & Elec. Co.*, 38 F.E.R.C. ¶ 61,242 (1987), *modified*, 40 F.E.R.C. ¶ 61,181 (1987).

169. *Pacific Gas*, 38 F.E.R.C. at 61,781-82.

170. *Id.*

experiment involved coordination services only and was limited to two years commencing in June of 1987. Three commodities were involved: economy energy, firm capacity, and transmission services. Pricing was flexible between preauthorized ceilings and floors for all three commodities. Participation was open to any pool member or any utility interconnected with one of the listed participants, if the utility owned its own entitlement to generation and operated its own control area. The FERC attached a condition to the program to require the same twenty-five/seventy-five percent revenue-sharing treatment approved in Opinion No. 203.¹⁷¹

The FERC expressed interest in the WSPP experiment because of increases in efficiency it promised.¹⁷² Noting that not all utilities are equally proficient in building and operating power plants, the FERC stated that unrestrained competition promotes efficiency, at least in some segments of the industry, but added that captive markets cannot be so liberated: "In pursuing this approach, we have an obligation to protect consumers by not allowing pricing flexibility in those markets where buyers are totally captive. . . . [W]e need to be able to distinguish between those markets that are workably competitive and those that are not."¹⁷³

With respect to the bulk power market in the pool, the FERC felt that deregulation could be appropriate because all participants, by membership in the pool, were interconnected and had previously arranged transmission services among themselves. The FERC recognized that, because the WSPP experiment did not require open-access transmission but treated transmission as a market commodity, it was crucially different from the experiment authorized in Opinion No. 203; "[t]he WSPP will test the assertion that mandatory transmission is necessary for competition to develop."¹⁷⁴ The FERC justified this difference because of the apparent lack of market dominance of any participant, the available alternatives to transmission service, the existing voluntary transmission arrangements, and the experimental nature of the program.¹⁷⁵ The FERC indicated that data reporting aspects of the program were the most important, and modified the experiment to require that an independent consultant collect data and monitor the experiment.¹⁷⁶

The FERC's third major authorization in this area was made in *Baltimore Gas & Electric Co.* in August of 1987.¹⁷⁷ Baltimore Gas and Electric Company (BG&E) proposed to sell on a monthly basis its unutilized share of transmission capacity in the Pennsylvania-New Jersey-Maryland Interconnection's (PJM) extra-high voltage (EHV) line. The EHV line was used to import power from non-pool utilities, and each PJM member was allocated a fixed share of the line. BG&E would auction on the 20th of each month its unused share through a telephone exchange. BG&E would set a price minimum and

171. *Id.* at 61,799.

172. *Id.* at 61,789.

173. *Id.* at 61,790.

174. *Id.* at 61,794.

175. *Id.* at 61,794-98.

176. *Id.* at 61,800-03.

177. *Baltimore Gas & Elec. Co.*, 40 F.E.R.C. ¶ 61,170 (1978).

maximum, based on FERC approved rates for PJM exchange transactions, then sell ten percent increments to the highest bidder. The open bid procedure and the fact that participants had power supply alternatives available and all possessed relatively equal market power were relied upon to insure the operation of a competitive market.¹⁷⁸ Unlike Opinion No. 203 and the WSPP experiment, the BG&E auction was approved, not as an experiment, but without limitation.

In each case in which the FERC has authorized competitive bidding, there were important limitations and qualifying features. First, competitive bidding has been authorized only for coordination services. Requirements services, where the obligation to serve might arise, have not been competitively bid.¹⁷⁹ Second, the FERC has moved away from cost-based pricing in those cases, but has not entirely deregulated price. Rather, price can be freely bid over a range with a preauthorized maximum and minimum, and the range has been tied in some fashion to costs. Third, the question of access to transmission has been addressed. In Opinion No. 203, open-access transmission for all participants was assured. In *Pacific Gas & Electric Co.*, underlying transmission agreements between and among participants were in place even though transmission was one of the biddable commodities. In *Baltimore Gas & Electric Co.*, participants, by virtue of their PJM membership, had agreed to provide the necessary interconnection and wheeling. Fourth, each case was limited in terms of electrical commodity and geographic area.

On at least two occasions, the FERC has emphasized the limited scope of its experiments. In *Arizona Public Service Co.*, the FERC refused to extend Opinion No. 203 to allow sales of economy energy over a range between marginal variable cost and three times allocated base costs.¹⁸⁰ The FERC explained that Opinion No. 203 was a limited experiment and was conditioned on open-access wheeling.¹⁸¹ And, in Order No. 352-A, the Commission stressed that Opinion No. 203 authorized a limited experiment so that the Commission could learn whether economic incentives would induce greater efficiency and that broader application of its approach would be inappropriate.¹⁸²

2. The Competitive Bidding NOPR

The approach taken in the competitive bidding NOPR, unlike the two bulk power experiments and the capacity auction, is not limited to the coordination segment of the market. Rather, it purports to implement the avoided cost authority of the PURPA, which affects a market—the generation mar-

178. *Id.* at 61,538.

179. The FERC set for hearing the question of whether to deregulate bulk power or requirements sales by EUA, an owner of major capacity entitlements to the Seabrook nuclear unit. *EUA Power Corp.*, 33 F.E.R.C. ¶ 61,008 (1985). The issues raised, however, were resolved by settlement between EUA and contract purchasers. *EUA Power Corp.*, 35 F.E.R.C. ¶ 61,187 (1986).

180. *Arizona Pub. Serv. Co.*, 27 F.E.R.C. ¶ 61,182 (1984).

181. *Id.* at 61,345.

182. Order No. 352-A, *Treatment of Purchased Power in the Fuel Cost Adjustment Clause for Electric Utilities*, 26 F.E.R.C. ¶ 61,266 n.26 (1984).

ket—that has traditionally been regulated by state commissions as part of the retail service provided by integrated utility companies.¹⁸³

The NOPR rests on the FERC's power under section 210 of the PURPA to require utilities to buy power from QFs at just and reasonable, nondiscriminatory rates not in excess of the incremental cost of alternative electric energy.¹⁸⁴ To determine what the avoided cost is, the FERC has proposed to allow specific alternative sources to identify their costs by public bidding, thereby obviating the need to hypothesize avoided costs. The FERC's present PURPA rules do not preclude the use of competitive bidding in setting avoided cost rates.¹⁸⁵ The new proposal sets minimum requirements for bidding programs and would preclude nonconforming bidding programs.¹⁸⁶

In the NOPR, the FERC reviewed some of the problems in establishing avoided-cost rates that were identified in the regional PURPA conferences and noted that some participants had requested clarification from the FERC as to whether existing state bidding programs comply with the PURPA.¹⁸⁷ The FERC explained that states would have the option, if the competitive bidding proposal were adopted, of using the FERC's bidding procedures or continuing to rely on administratively determined avoided-costs. Abjuring any intent to disrupt existing state bidding programs, the FERC sought comments on what changes, if any, including grandfather provisions, would be required to avoid "chilling" development of state bidding programs.¹⁸⁸ The FERC also claimed that its proposal would not alter states' traditional responsibilities regarding certification of need for capacity, environmental and siting regulation, and prudence reviews.¹⁸⁹

As proposed by the FERC, a qualified competitive bidding program would have the following attributes:

- (1) It would apply to capacity rates only and would not determine avoided energy cost payments for QFs. A QF that chose not to participate in bidding or lost on the basis of its bid would get no capacity payment but would still be entitled to avoided energy payments.¹⁹⁰
- (2) States would have the option of using all source bidding, or limiting participation in the bidding, provided that all sources are taken into account and the PURPA's basic criteria are satisfied. All source bidding would include QFs, utilities and IPPs. Restricted bidding might be open only to QFs. However, the NOPR would require that any excluded sources—such as utilities and IPPs—would have to be taken into account in setting a benchmark

183. There have been the FERC inroads into the generation market, an example of which is the Grand Gulf plant owned by the Middle South Utilities Holding Company. See *infra* note 284.

184. 16 U.S.C. § 824a-3(b) (1982).

185. Meade, *supra* note 42; Haman-Guild & Pfeffer, *Competitive Bidding for New Electric Power Supplies: Deregulation or Reregulation?*, 120 PUB. UTIL. FORT., Sept. 17, 1987, at 9.

186. 18 C.F.R. §§ 293.101(a), .102(a) (1988).

187. Competitive Bidding NOPR, *supra* note 135, at 32,023.

188. *Id.* at 32,024-25.

189. *Id.* at 32,025.

190. *Id.*

avoided-cost calculation for the bidding program.¹⁹¹

- (3) States could subject all new capacity or only certain blocks of capacity to bidding, but if some blocks are reserved from bidding, QFs must be afforded an opportunity to satisfy the reserved capacity requirement.¹⁹²
- (4) Bids must be submitted simultaneously, and there can be no negotiations between the purchaser and any bidder until after the bidding process has been concluded and a winner has been selected.¹⁹³
- (5) If QFs and non-QFs submit tie bids, a preference must be afforded to the QF bid.¹⁹⁴
- (6) Non-price criteria must be specified in writing and reflected in the bid solicitation. Any limitations in participation would also be specified in writing and included in the solicitation.¹⁹⁵
- (7) The state using bidding would have to certify the winning bid and price in order to ensure state participation in the process.¹⁹⁶
- (8) States would have the option of excluding subsidized entities from participation.¹⁹⁷
- (9) There must be a written explanation of the need for capacity that identifies the characteristics of the capacity needed.¹⁹⁸
- (10) Selection criteria must be specified in advance, and the FERC has recommended that the state certify the criteria.¹⁹⁹
- (11) States must take steps to avoid utility self-dealing, if utilities are allowed to participate in bidding, but the FERC has not specified any criteria in its proposed rules on this point.²⁰⁰
- (12) States can exempt QFs of one MW or less from bidding. Exempted QFs may still be entitled to capacity payments at a rate set in public bidding as long as the purchasing utility does not have surplus capacity.²⁰¹

With respect to issues of dispatchability and reliability, the FERC was of the view that contract provisions and performance bonds could adequately handle potential problems.²⁰² The FERC also felt that it was unnecessary to condition bidding on access to transmission because bidding is merely an alternative for identifying avoided-costs and it would not increase the purchasing utility's market power.²⁰³ The FERC also expressed grave reservations as to

191. *Id.* at 32,032-33 (to be codified at 18 C.F.R. § 293.203).

192. *Id.* at 32,031 (to be codified at 18 C.F.R. § 293.202).

193. *Id.* at 32,033 (to be codified at 18 C.F.R. § 293.206).

194. *Id.* at 32,028 (to be codified at 18 C.F.R. § 293.207).

195. *Id.* at 32,034-35 (to be codified at 18 C.F.R. § 293.204).

196. *Id.* at 32,035-36 (to be codified at 18 C.F.R. § 293.211). In the case of a non-regulated utility, the utility would provide certification.

197. *Id.* at 32,037 (to be codified at 18 C.F.R. § 293.203(c)).

198. *Id.* at 32,038 (to be codified at 18 C.F.R. § 293.203(b)(1)).

199. *Id.* at 32,040 (to be codified at 18 C.F.R. § 293.203(b)(2)).

200. *Id.* at 32,041-42.

201. *Id.* at 32,043 (to be codified at 18 C.F.R. § 293.210).

202. *Id.* at 32,042.

203. *Id.* at 32,044.

its legal authority to require access to transmission. The FERC requested further comments on "wheeling in" (provision of transmission service to other bidders by a utility bidding to supply another utility) and "wheeling out" (provision of transmission service by a utility bidding to supply its own capacity).²⁰⁴ Finally, the FERC observed that it would publish a draft environmental impact statement on its proposal at an unspecified future date.²⁰⁵

3. Legal Authority for Competitive Bidding

The competitive bidding proposal raises numerous questions, none the least of which is the legal authority for such a proposal under the PURPA and the FPA. The competitive bidding proposal hinges on section 210(b) of the PURPA, which requires electric utilities to purchase electric energy from QFs at no more than "the incremental cost to the electric utility of alternative electric energy."²⁰⁶ Section 210(d) defines "incremental cost of alternative energy" as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source."²⁰⁷ The FERC has further defined the incremental cost of the alternative electric energy as "the avoided cost" that a particular utility experiences if it buys QF power.²⁰⁸

The competitive bidding proposal would solicit bids for blocks of additional capacity as needed. The next to lowest qualifying bid would establish the avoided cost of energy under the PURPA. The next to lowest bid establishes the avoided cost because the lowest bid wins and the next to lowest bid is "avoided." For purposes of section 210 of the PURPA, therefore, it is argued that the bidding process establishes the "incremental cost of alternative electric energy" and thereby the proper rate for QF purchases.

The bidding process does more, however. If a QF submits or ties the winning bid, then it has the right to sell capacity to the utility. If a participating QF does not submit the winning bid, then the utility is under no obligation to buy capacity from that QF. The FERC argues that this is consistent with section 210(b) of the PURPA, which requires that QF purchase rates must be just and reasonable for the electric consumers of the electric utility buying the QF power. If QF power is more expensive than alternatives, then it is not just and reasonable to electric consumers, and it should not be allowed to displace cheaper or more efficient generation. Moreover, if QF power is not the lowest priced, then it is not available at the incremental cost, and its purchase is not required by the PURPA section 210.²⁰⁹

It could be argued, however, that competitive bidding does not comply with section 210 of the PURPA. For example, assume that a QF and an independent producer submit competing bids, and the independent producer's

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

205. *Id.* at 32,047.

206. 16 U.S.C. § 824a-3(b) (1982).

207. *Id.* at § 824a-3(d) (1982).

208. 18 C.F.R. § 292.101(b)(6) (1988).

209. See Competitive Bidding NOPR, *supra* note 135, at 32,028.

bid is lower. If bids are submitted simultaneously, neither would know the other's bid until submission. In that event, QF supporters have a strong argument that the QF should be given a chance to match the lower independent producer's bid, because the PURPA *requires* that available QF power be purchased at the avoided cost rate. If the QF is willing to sell power at the rate established in the lower bid, then QF power is available at the lower rate, and the PURPA requires that the utility purchase the power from the QF at that rate. The FERC rejects this argument saying that all the PURPA requires is that utilities offer to purchase QF power at non-discriminatory rates.²¹⁰

If QFs were in fact given the option of matching any winning bid, then there is a question as to whether non-QFs would participate in the competitive bidding process. Utility companies and independent producers might not want to incur the expense of preparing a bid if their participation, in effect, is allowed solely to establish a rate for purchases from QFs. The FERC cites this as one reason for not allowing QFs a "second bite at the apple."²¹¹

The FERC's reliance on section 210 of the PURPA for its competitive bidding proposal has additional problems. The overriding purpose of the PURPA is to develop generating resources that do not rely on oil and natural gas as fuel. Indications are that competitive bidding will have the opposite effect; it will increase the reliance on generators that use oil or natural gas as a fuel.²¹² Indeed, the proposal would waive QF efficiency standards for winning bidders, thereby removing existing restraints on expanded oil and natural gas dependence.²¹³ Seen in this light, the competitive bidding proposal appears to conflict directly with the basic policy underlying the PURPA.

Another legal question respecting competitive bidding is whether a competitively bid rate complies with section 205 of the FPA.²¹⁴ This question arises because, if a non-QF wins the competitive bid, the sale of electricity from the non-QF would in all likelihood be a sale for resale in interstate commerce which is subject to the FERC jurisdiction under section 205.²¹⁵ The non-QF would be a public utility or IPP subject to section 205.

The FERC has argued in some recent decisions that the just and reasonable standard of section 205 does not require that the FERC follow the traditional utility ratemaking standard of cost-based rates.²¹⁶ In the competitive bidding NOPR, the FERC asserts that market-oriented pricing complies with section 205 if there is no market dominance and there is workable competition.²¹⁷ This position, however, is subject to some debate. In *FPC v. Natural Gas Pipeline Co. of America*, the Supreme Court tied the just and reasonable standard under the Natural Gas Act to the concept of cost-based ratemak-

210. *Id.*

211. *Id.*

212. Trabandt dissent, *supra* note 5, at 32,080.

213. 18 C.F.R. § 293.208 (1988).

214. 16 U.S.C. § 824d (1982).

215. *See infra* note 239.

216. Public Serv. Co. of N.M., 25 F.E.R.C. ¶ 61,469 (1983); *see* Baltimore Gas & Elec. Co., 40 F.E.R.C. ¶ 61,170 (1987); Pacific Gas & Elec. Co., 38 F.E.R.C. ¶ 61,242 (1987).

217. Competitive Bidding NOPR, *supra* note 135, at 32,028.

ing.²¹⁸ Cases decided since *FPC v. Natural Gas Pipeline Co.* recognize that the FERC has flexibility, but warn that the basic constitutional parameters (which are cost-based) must be followed. For example, *FPC v. Hope Natural Gas Co.* espouses an end-result approach,²¹⁹ yet the decision approved a traditional cost-based approach to rates (using for rate base the original cost less depreciation, in lieu of replacement cost) and called for a balancing of rate-payer and utility shareholder interests. In *Permian Basin Area Rate Cases*, the Supreme Court approved regional rates for wellhead gas, rather than rates based on well-specific costs, but required that the rates must fall within an agency-determined zone of reasonableness and that the agency must consider and balance pertinent factors identified in the *Hope* case, i.e., the utility's costs and the interests of ratepayers as contrasted with those of the utility's stockholders.²²⁰ In *FPC v. Texaco*, the Supreme Court stressed that deviations from cost-based ratemaking must be specifically justified and that the "marketplace cannot be relied upon as the final measure of 'just and reasonable' rates."²²¹

Several attempts by the FERC to let market forces set rates have been rejected.²²² The lessons of *Farmers Union Central Exchange, Inc. v. FERC*, cannot be ignored.²²³ There the FERC approved market-based rates for oil pipelines as just and reasonable under the Interstate Commerce Act.²²⁴ The D.C. Circuit reversed, holding that the FERC had not justified its departure from cost-based rates:

Because the relevant costs, including the cost of capital, often offer the principal points of reference for whether the resulting rate is "less than compensatory" or "excessive," the most useful and reliable starting point for rate regulation is an inquiry into costs . . . "[E]ach deviation from cost-based pricing [must be] found not to be unreasonable and to be consistent with the Commission's [statutory] responsibility."²²⁵

Farmers Union is particularly apropos here because the FERC, in its NOPRs, has relied on changing characteristics of the electric utility industry to justify a departure from cost-based ratemaking. The very same rationale was employed by the FERC with respect to oil pipelines and was rejected by the D.C. Circuit:

218. *FPC v. Natural Gas Pipeline Co. of America*, 315 U.S. 575 (1942).

219. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). The Court held that "the Commission was not bound to the use of any single formula or combination of formulae in determining rates. . . . Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." *Id.* at 602.

220. *Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 791-92 (1968). See also, *FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517-18 (1979); *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1177-80 (D.C. Cir. 1987).

221. *FPC v. Texaco*, 417 U.S. 380, 394, 397-99 (1974). See also, *Pennzoil Producing Co.*, 439 U.S. at 518; *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 308-09 (1974).

222. E.g., *FPC v. Texaco*, 417 U.S. 380 (1974); *Bel Oil Corp. v. FERC*, 255 F.2d 548, 553 (5th Cir. 1958), *cert denied*, 358 U.S. 804 (1958); *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955), *cert denied*, 352 U.S. 829 (1956).

223. *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir. (1984)), *cert. denied*, 469 U.S. 1034 (1984).

224. 49 U.S.C. § 1(5) (1982).

225. *Farmers Union*, 734 F.2d at 1502 (quoting *Mobil Oil*, 417 U.S. at 308).

In some circumstances, the contrasting or changing characteristics of regulated industries may justify the agency's decision to take a new approach to the determination of just and reasonable rates. We find, however, that in this case FERC has not merely developed a new method for determining whether a rate is just and reasonable; rather, it has abdicated its statutory responsibilities in favor of a method that, by its own description, guards against only grossly exploitative pricing practices. FERC wrongly assumed that the statutory phrase just and reasonable . . . is a mere vessel into which meaning must be poured. While we agree that the statutory phrase sets down a flexible standard, an agency may not supersede well established judicial interpretation that structures administrative discretion under the statute. An agency may not pour any meaning it desires into the statute. To accept FERC's view of its own latitude would be tantamount to holding that *no* standards accompany the delegation of ratemaking authority to FERC, and we think such a delegation would be impermissible.²²⁶

The court called the FERC's reliance on market forces to substitute for regulation an "apologia for virtual deregulation,"²²⁷ and held that reliance on unchecked, free market forces could not satisfy the just and reasonable standard.²²⁸ The FERC was chided for "undocumented reliance on market forces,"²²⁹ and for going "far beyond . . . rational or permissible assumptions about the relationship between 'just and reasonable rates' and the market price."²³⁰ The court further stated that it had allowed agencies to reduce regulatory oversight dramatically, but only where the court "found that the agency adequately assured meaningful enforcement of the public interest standard."²³¹ The FERC's approach was rejected because "presumed market forces may not comprise the principal regulatory constraint."²³²

Farmers Union teaches that economic efficiency cannot be pursued as the ultimate goal of public utility ratemaking, unless it can be justified under the public interest standard. In that case, moreover, enhancing the public interest is the ultimate goal, not economic efficiency. *Farmers Union* also rejects resort to economic theories which are unsupported by hard, factual evidence, and demands precise justification for any moves away from cost-based pricing. The FERC's competitive bidding proposal appears to be the type of "apologia for virtual deregulation" that so distressed the *Farmers Union* court.

Vulnerability in this respect is heightened because, without open access to the "market" via wheeling, the market must necessarily function imperfectly. The existence of a market implies that there are numerous sellers *and* numerous buyers, a situation that can exist only if there is free and open access to the "market." In the generation of electricity, there may be several potential sellers (QFs, a utility, IPPs), but there may be only one buyer—the local distribution utility, for example. There may also be only one or a very few sellers in specific cases. There is no attempt in the NOPR to explain how a workably competitive market will develop in the absence of open access transmission.

226. *Id.* at 1503-04 (citations omitted).

227. *Id.* at 1507.

228. *Id.* at 1507-08.

229. *Id.* at 1508.

230. *Id.* at 1509.

231. *Id.* at 1510.

232. *Id.* at 1530. The court also advised that original cost methodology should be reexamined by the FERC because of its advantages in meeting the statutory test. *Id.*

In this regard, the competitive bidding proposal is inconsistent with statements in the 1985 NOI and with prior FERC opinions that have authorized limited competitive pricing programs. In prior decisions, the FERC observed that there was ready access to the market, and the FERC acknowledged the importance of market access.

A major problem for the competitive bidding proposal is whether there is any factual justification for the FERC rules allowing competitive bidding in the generation market. A detailed, factual analysis of the generation market is lacking in the competitive bidding proposal. In the FERC opinions authorizing competitive bidding in coordination transactions, the FERC carefully analyzed all aspects of the affected markets. Approval of competitive bidding was limited to defined product and geographic markets and conditioned on arrangements to insure maintenance of competition in those markets. The FERC's findings on these issues were based on the facts presented in each case. It would seem that, absent similar detailed analysis of the generation market, competitive bidding is open to challenge.

Recalling the basic principles of electric utility law, the FERC's responsibility under the FPA is to insure the provision of safe, adequate and reliable service at the lowest reasonable cost. The FERC's competitive bidding proposal raises numerous questions regarding the adequacy and reliability of service,²³³ yet there is no record support for the FERC's glib assertions that such issues can be handled as a matter of contract law. A reviewing court might therefore find any final rule based on such a record to be unsupported by substantial evidence and an abuse of discretion.²³⁴

A final area of concern involves the authorization to exclude subsidized entities from competitive bidding. As noted by Commissioner Trabandt,²³⁵ the FERC's proposal could be in conflict with other federal statutes and treaties. If, for example, the DOE has authorized imports of power from Quebec pursuant to the U.S.-Canadian free trade agreement, it is questionable whether the FERC can or should authorize a state to exclude those imports from a competitive bidding market. It also should be remembered that the FERC is acting under the PURPA, which contains explicit antidiscrimination provisions.²³⁶ Any discrimination against subsidized entities would have to be justified by sound factual reasons.²³⁷

In summary, the FERC's competitive bidding proposal raises very substantial legal questions. The feature of the proposal that generates the most uncertainty is the "all source" provision. If a competitive bidding program were limited to QFs, and if it were based on a selling utilities "benchmark" avoided costs determined under the new ADFAC rules, then perhaps the program would avoid the legal problems noted above. Where, however, IPPs can

233. Trabandt dissent, *supra* note 5, at 32,082-83.

234. See, e.g., MPCII, 761 F.2d 768, 776-77 (D.C. Cir. 1985); Electric Consumers Resources Council v. FERC, 747 F.2d 1511 (D.C. Cir. 1984); City of Charlottesville v. FERC, 661 F.2d 945 (D.C. Cir. 1981).

235. Trabandt dissent, *supra* note 5, at 32,079, 32,084.

236. 16 U.S.C. §§ 824a-3(b)(2), (c)(2) (1982).

237. See, e.g., Public Serv. Co. v. FERC, 575 F.2d 1204, 1212 (7th Cir. 1978); St. Michaels Utils. Comm'n v. FDC, 377 F.2d 912, 915 (4th Cir. 1967).

displace QFs and utilities to provide generation, and where the FERC abdicates its responsibilities under the FPA to determine whether rates of jurisdictional utilities are just and reasonable, competitive bidding is inconsistent with both the PURPA and the FPA.

C. IPPs

IPPs, by definition, generate electric power for resale and do not qualify as QFs.²³⁸ Although they are not traditional utilities in that they do not have franchised service areas, they are subject to FERC jurisdiction as "public utilities." Non-QF generating companies are subject to FERC jurisdiction because, with the exception of sales in the states of Hawaii, Alaska, and part of Texas, virtually any sale for resale of electricity is in interstate commerce.²³⁹ Jurisdictional utilities are subject to the full panoply of the FERC's regulation.

Parts II and III of the FPA, particularly sections 203, 204, 205, 206, 304, and 305,²⁴⁰ and the Public Utility Holding Company Act (PUHCA)²⁴¹ impose substantial regulatory burdens on public utilities. Section 203 of the FPA precludes mergers, acquisitions, disposition of property worth more than \$50,000, or purchases of securities by any jurisdictional utility that has not first secured the FERC's approval after notice and opportunity for a hearing. Section 204 prevents a jurisdictional utility from issuing or guaranteeing securities without first obtaining the FERC's approval based upon a determination that the purpose of the issuance is consistent with the public interest, after notice and opportunity for a hearing. Section 304 requires that annual reports be filed. Section 305 precludes interlocking directorates and the holding of certain positions in utilities by other utility managers, bankers, or securities dealers, without the FERC's approval. Section 205 precludes rates, conditions and terms of service that are not just and reasonable or that are unduly preferential or discriminatory and requires each jurisdictional utility to file schedules showing all rates and charges with the FERC. No change is allowed in filed schedules except after 60 days' notice and opportunity for hearing. None of these statutory requirements can be waived by the FERC, and the FERC has no jurisdiction to change the requirements of the PUHCA, which imposes a host of additional requirements on utilities that qualify as holding companies.

Regulations implementing these statutes are tailored for large, interstate utilities engaged in wholesale service and go far beyond the minimum statutory requirements. Concerning filing of support for rate changes, 18 C.F.R. part 35 requires that voluminous cost-of-service schedules for a base year and projected test year be filed. To monitor cost-based ratemaking, part 101 of the FERC's regulations²⁴² implements a detailed system of accounts for public

238. IPP NOPR, *supra* note 135, at 32,103.

239. A public utility is any person who owns or operates facilities subject to the FERC's jurisdiction. 16 U.S.C. § 824(e) (1982). Also, the FERC's jurisdiction extends to all facilities for transmission in interstate commerce and sales for resale in interstate commerce. *Id.* § 824(b).

240. 16 U.S.C. §§ 824b-e, 825c-d (1982).

241. 15 U.S.C. §§ 79 to 79z-6 (1982). The PUHCA confers jurisdiction on the Securities Exchange Commission to regulate securities dealing and transactions of public utility holding companies.

242. 18 C.F.R. pt. 101 (1988).

utilities. Part 141²⁴³ requires the filing of detailed annual statements describing all facilities and transactions. Regulations in parts 33, 34, 45 and 46 require reports to monitor all property transactions, acquisitions and issuance of stock, mergers, interlocking positions, and similar matters.²⁴⁴ Part 36 imposes fees and annual charges that are designed to recover administrative costs incurred by the FERC in processing requests and monitoring utility filings.²⁴⁵ To the extent these regulations go beyond statutory requirements, their application is a matter of discretion for the FERC.²⁴⁶

1. Precedent

The FERC's treatment of regulated QFs, which is discussed above, provides precedent for waiver of regulatory requirements. The FERC identified in *Resources Recovery (Dade County)* those of its regulations that could be waived to permit regulated QFs a freer rein in competing in the generation market. There are other FERC decisions which have granted waivers similar to those granted in *Resources Recovery (Dade County)*, but which, unlike *Resources Recovery*, deal expressly with entities that can be considered to be IPPs.

Certain sellers of electricity have sought waivers of the FERC's regulations, arguing that they are not wholesale electric utilities in the traditional sense. In *St. Joe Minerals Corp.*,²⁴⁷ two coal-fired generating plants with a combined capacity of 110 MW were owned by a minerals company and used to provide power to a smelter. The company was also selling 65 MW to a utility. The company planned to reduce utility sales as its smelter needs grew. The FERC found the sales for resale to be in the public interest and waived the applicability of the uniform system of accounts, requirements for reports and statements, and full cost-of-service statements to support initial and changed rates. The company was required merely to file its rates and changes, supported by some unspecified back-up data.²⁴⁸ With respect to regulations under sections 203, 204 and 305 of the FPA, the company was required to heed the notice provisions. However, the data filing requirements were abbreviated for these transactions. Waiver of annual charges was also granted. In its rehearing order, the FERC gave blanket approval for all future issuances of securities and assumption of liabilities, provided those actions are consistent with St. Joe's corporate charter. In short, the FERC retained the minimal regulation, under abbreviated filing provisions, consistent with the statutory requirements of the FPA.

In *Cliffs Electric Service Co.*,²⁴⁹ the FERC was asked to extend *St. Joe*.

243. *Id.* pt. 141.

244. *Id.* pts. 33, 34, 45 & 46.

245. *Id.* pt. 36.

246. The power to prescribe rules and regulations to implement the FPA is conferred in 16 U.S.C. § 825h (1982).

247. *St. Joe Minerals Corp.*, 21 F.E.R.C. ¶ 61,323 (1982), *modified on reh'g*, 22 F.E.R.C. ¶ 61,211 (1983).

248. Rate schedule filings by St. Joe were subsequently approved. *St. Joe Minerals Corp.*, 23 F.E.R.C. ¶ 61,208 (1983).

249. *Cliffs Elec. Serv. Co.*, 32 F.E.R.C. ¶ 61,372 (1985).

The FERC explained and refined the *St. Joe* holding, justifying it on the grounds of *St. Joe's* non-utility status, benefits to the local economy, and fuel savings. In *Cliffs*, four industrial concerns and one small utility sought waivers similar to those granted in *St. Joe*. The FERC emphasized that, in order to obtain a waiver, the petitioner must generally be engaged in nonutility business. A two part test was set out: (1) the petitioner must demonstrate that its facilities "were built and are used primarily for a non-public utility purpose," and (2) the petitioner must show facts similar to those in *St. Joe* related to the amount of revenues derived from sales to utilities, the temporary nature of the obligation to sell and whether the sales are interruptible. Utilities to be granted waivers were also required to file rates and cost support data for their rates, although complete cost-of-service data required by part 35 could be waived.

With respect to three of the *Cliffs* petitioners, the FERC found they satisfied the *St. Joe* criteria. A fourth was found to have built its generators primarily to make sales to a utility and in fact made most sales on a long-term basis to a utility. Waiver was denied. The small utility was granted some waivers, including uniform system of accounts and certain reporting and rate change filing requirements (cost-of-service schedules). As in *St. Joe*, abbreviated filings were allowed for nonwaivable statutory notice requirements. Blanket approval for securities issuances was authorized.

In *Citizens Energy Corp.*,²⁵⁰ a nonprofit wholesale buying and selling agent that owned no generation, transmission, or distribution facilities sought waiver of accounting and reporting requirements, annual fees, interlocking positions, and cost-of-service filing requirements and sought blanket authority for securities issuances. Applying *St. Joe* and *Cliffs* standards, waivers were granted, but the FERC required Citizens to comply with parts of its cost-of-service requirements for rate filings because Citizens was in the utility business. The FERC distinguished between brokerage transactions, in which Citizens did not actually take title to the power, and resale transactions, in which Citizens bought and then resold power. It held that the latter is jurisdictional, while the former is not.²⁵¹ The FERC stated Citizens would have to provide notice of new rates and rate changes and subject its rates to the FERC's review based on cost-of-service data. But in other respects waivers similar to those of *St. Joe* were granted. In Citizens' first rate filing, the FERC approved an equal sharing of profits of the wholesale transactions between ratepayers of the purchaser and seller as analogous to "split savings" rates normally approved for economy energy transactions.²⁵²

The FERC extended the *Citizens Energy Corp.* waivers to a for-profit wholesale buying and selling agent in *Howell Gas Management Co.*²⁵³ Howell requested a disclaimer of jurisdiction, or alternatively, waivers. The FERC

250. *Citizens Energy Corp.*, 35 F.E.R.C. ¶ 61,198 (1986). The FERC denied a request by Citizens that the FERC disclaim jurisdiction. In so ruling, the FERC distinguished *Public Serv. Co. of N.M.*, 29 F.E.R.C. ¶ 61,387 (1984), wherein jurisdiction of a utility sale-leaseback transaction was disclaimed.

251. 35 F.E.R.C. ¶ 61,198, at 61,452.

252. *Citizens Energy Corp.*, 36 F.E.R.C. ¶ 61,332 (1986).

253. *Howell Gas Mgmt. Co.*, 40 F.E.R.C. ¶ 61,336 (1987).

refused to disclaim jurisdiction but explained the extent of jurisdiction exercised under section 203 of the FPA. The FERC made clear that jurisdiction extended only to facilities used in the interstate sales of electricity for resale and not to Howell's natural gas facilities.²⁵⁴

Regarding the rationale for granting waivers, the FERC observed that Howell, like Citizens, did not own generation, transmission or distribution facilities, and that it would engage only in "back-to-back" economy sales intended to generate a margin. The FERC decided that the for-profit aspect, the only difference between Citizens and Howell, did not require a different result.²⁵⁵ The FERC did not explain its reasoning.

In both *Citizens* and *Howell*, the FERC addressed the question of rate regulation by imposing an agreement to make refunds should the FERC subsequently determine (after a complaint or under its own initiative) that rates were unjust or unreasonable.²⁵⁶ The FERC indicated that this condition was necessary to fulfill its obligations under section 205 of the FPA because rate filings would not be screened by the FERC and, as initial rates, the rates charged would not otherwise be subject to refund.²⁵⁷

In *Orange & Rockland Utilities, Inc.*,²⁵⁸ the FERC allowed an electric utility to obtain waivers of regulations and abbreviated filing requirements on behalf of certain of its industrial customers. Orange & Rockland proposed to buy 50 MW of peaking capacity from its customers at Orange & Rockland's avoided cost rates under contracts ranging from one to five years in duration. *St. Joe*-type waivers of rate regulation and other filing requirements were sought for the approximately forty non-QF or IPP customers. On the issue of reliability, Orange & Rockland noted it would be using customer-owned generation for peak shaving in small increments at a number of different locations and at Orange & Rockland's request. No decrease in system reliability was anticipated, and the customers were to be penalized if they did not generate at Orange & Rockland's request.

The FERC approved Orange & Rockland's request on the grounds that it met all of the criteria specified in *St. Joe* and *Cliffs*.²⁵⁹ With respect to the fact that Orange & Rockland made the filing, the FERC reasoned that it had permitted surrogate filings in power pool transactions and that requiring each IPP, from whom Orange & Rockland proposed purchases, to make a filing would discourage the sales.²⁶⁰ Concerning the justness and reasonableness of rates, it noted that the requirement imposed by reviewing courts of a range within which market prices can operate was met because Orange & Rockland's avoided cost rate set a cap on rates and the IPP's voluntary participa-

254. *Id.* at 62,023-24. Howell indicated that it also bought and resold natural gas, and was a subsidiary of a gas exploration, production, and transportation company, and that jurisdiction under the FPA should not extend to its other facilities. The FERC agreed.

255. *Id.* at 62,025.

256. *Id.* at 62,026; Citizens Energy Corp., 35 F.E.R.C. ¶ 61,198, at 61,456 (1986).

257. *Id.*

258. Orange & Rockland Utils., Inc., 42 F.E.R.C. ¶ 61,012 (1988).

259. *Id.* at 61,029. The FERC did not address the traditional utility function criterion.

260. *Id.* at 61,028.

tion set a floor on rates.²⁶¹ The FERC agreed that, because of the penalty imposed if an IPP refused to generate and the dispersed nature of the IPPs, reliability would be unaffected. Finally, the FERC imposed no rate refund agreement, as it did in *Citizens* and *Howell*.

Criteria developed in the *St. Joe* line of cases to grant waivers for IPPs include (1) that the generators used be owned by other than a utility, (2) that the generators be used primarily for a purpose other than utility service, (3) that the electricity sales be temporary, (4) that the proposed sales be in the public interest, and (5) that denial of the requested relief would be unduly burdensome. The public interest criterion has included consideration of the rates, system reliability, and the goals of energy conservation, fuel diversity and economic efficiency. The second criterion, non-utility function, has been called into question by *Orange & Rockland Utils., Inc.*, 43 F.E.R.C. ¶ 61,067 (1988).

2. The IPP NOPR

In the IPP NOPR, the FERC went to considerable lengths to establish a basis for proceeding with a rulemaking on IPPs. Noting that it has an obligation to review its policies and rules "to assure the most efficient production and allocation of wholesale electric energy in order to provide the lowest cost and reliable energy to consumers,"²⁶² the FERC "tentatively concluded" that lessening regulatory burdens on IPPs is necessary to assure future reliability of service and reasonable cost for consumers.²⁶³ This conclusion was based on a review of industry literature and comments submitted to the FERC in the 1985 NOI and the regional PURPA conference from which the FERC concluded that there is a real reluctance on the part of traditional utilities to invest in new baseload generation plants.²⁶⁴ The FERC then reasoned that traditional utility-type cost-of-service regulation stifles technological innovation and cost-minimization, thereby impairing economic efficiency.²⁶⁵ And, while cost-of-service regulation might be appropriate to protect the public from the exercise of monopoly power, the FERC reasoned it is not necessary for sellers of electricity who lack market power.²⁶⁶ The FERC therefore proposed to relax regulatory burdens for IPPs, which the FERC has carefully defined in the proposed regulations.

As defined in the NOPR, a seller of electricity that would otherwise meet the definition of a public utility under section 201(e) of the FPA²⁶⁷ qualifies as an IPP if:

- (1) It sells power from an independent power facility (IPF), which in turn is a facility or portion of a facility that is not in a public utility's

261. *Id.*

262. IPP NOPR, *supra* note 135, at 32,103.

263. *Id.* at 32,105-06.

264. *Id.*

265. *Id.* at 32,108-09.

266. *Id.*

267. 16 U.S.C. § 824(e) (1982).

ratebase (is not subject to cost-of-service regulation).²⁶⁸

- (2) It does not control transmission facilities essential to the customer purchasing electric energy from the IPP. "Control" means the ability, directly or through an affiliate or other intermediary, to prevent the use of transmission facilities.²⁶⁹ Transmission facilities are essential to a customer, if they supply fifty percent or more of the customer's needs for electricity.²⁷⁰
- (3) The IPP or its affiliate does not have a utility franchise service territory, or if it does, the customer buying IPP power is outside the franchise service territory.²⁷¹
- (4) An IPP merely has to meet the definition of the regulations to receive IPP treatment, but it can also file in advance to obtain IPP certification from the FERC.²⁷²

If a seller qualifies as an IPP, the proposed rule would relax regulatory requirements in several respects:

- (1) Any rate filed, if filed 60 days prior to taking effect, would be deemed just and reasonable if it is at or below the purchaser's avoided-cost.²⁷³ Avoided-cost is determined by the purchaser's verified statement, a state regulatory agency, or a qualified bidding program.
- (2) Application requirements for rate approval would include filing of rate schedules, explanations of the service, identification of any franchise service territory or transmission facilities of the IPP, and copies of any contracts.²⁷⁴ No back-up data or cost-of-service information would be required.
- (3) Once approved, current rate schedules would have to be maintained on file at the FERC, and purchasers would have to be notified 60 days in advance of any changes in service or rates.²⁷⁵
- (4) Abbreviated, notice-type filings would be authorized by IPPs for disposition, merger or consolidation of facilities or acquisition of securities subject to section 203 of the Federal Power Act, and IPPs would be exempt from 18 C.F.R. parts 41, 50, 101 and 141 relating to accounting and reporting requirements.²⁷⁶
- (5) Pre-granted blanket authorization would be available, subject to abbreviated filing requirements, for issuance of securities, assump-

268. IPP NOPR, *supra* note 135, at 32,110.

269. *Id.*

270. *Id.* at 32,111.

271. *Id.* at 32,112.

272. *Id.* at 32,131-32.

273. *Id.* at 32,127.

274. *Id.* at 32,123.

275. *Id.*

276. *Id.* at 32,123. The FERC made no attempt to address PUHCA requirements, which are beyond the FERC's jurisdiction. Proposals to relax PUHCA requirements have been considered by Congress. See, *Hearings Before the Subcomm. on Energy and Power, House Comm. on Energy and Commerce*, 100th Cong., 2nd Sess. (1988).

tion of liabilities, and holding of interlocking positions.²⁷⁷

The FERC opined that its proposed IPP policy would bring into production existing industrial generation and new generators using innovative technology and would expand opportunities for utilities with excess capacity to market their excess capacity beyond their service territories.²⁷⁸ The FERC also reasoned that at least some risks of construction and operation would be shifted from customers and shareholders of utilities to the IPPs.²⁷⁹ The FERC also observed that its IPP proposal would lessen the incentive for "PURPA machines."²⁸⁰

The FERC was of the view that its proposal would not adversely affect a franchise utility's obligation to serve. The FERC claimed there is no express wholesale obligation to serve, other than that created by contract, but that utilities are free to subject themselves to that risk even without the IPP proposal by relying on purchased power.²⁸¹ Utilities "will probably maintain diversity . . . and not rely too heavily on one particular IPP," according to the FERC, and will learn to use contract provisions, security interests, and bonding to secure reliability.²⁸² Concerning the effect of IPPs on power pools, the FERC again relied on the voluntary nature of utility purchases from IPPs to conclude there would be no adverse effect.²⁸³

The FERC's reliance on the voluntary nature of purchases from IPPs is curious because, if both the competitive bidding and IPP NOPRs are adopted, utilities could well be compelled to purchase substantial quantities of power from IPPs that participate successfully in capacity bidding programs. The FERC made no attempt in its notice to address the compulsory reliance on IPP power through competitive bidding programs.

As with the competitive bidding NOPR, the FERC stated that a draft environmental impact statement will be issued, and opportunity for public review and comment on it will be provided.

3. Legal Problems Posed by the IPP NOPR

The proposed IPP policy would likely have major impacts on state jurisdiction over utility generating resources despite the FERC's disclaimers. Recent FERC decisions, principally those in the *Middle South* cases²⁸⁴ and the *AEP Service Corp.* cases,²⁸⁵ and the Supreme Court's *Nantahala* deci-

277. *Id.* at 32,129-30.

278. *Id.* at 32,114-16.

279. *Id.* at 32,116-17.

280. *Id.*

281. *Id.* at 32,118 n.122, 32,119.

282. *Id.* 32,119-20.

283. *Id.*

284. *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305 (1985), *aff'd*, *Mississippi Indus. v. FERC*, 808 F.2d 1525 (D.C. Cir.), *modified*, 822 F.2d 1104 (D.C. Cir.), *cert. denied sub. nom. Arkansas Power & Light Co. v. FERC*, 108 S. Ct. 500 (1987). *See also* *New Orleans Pub. Serv., Inc. v. City of New Orleans*, 782 F.2d 1236 (5th Cir.), *modified on reh'g*, 798 F.2d 858 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 506 So. 2d 978 (Miss. 1987), *rev'd*, 108 S. Ct. 2428 (1988).

285. *Appalachian Power Co. v. Public Serv. Comm'n*, 812 F.2d 898 (4th Cir. 1987); *AEP Generating*

sion,²⁸⁶ illustrate how the exercise of the FERC's jurisdiction over a particular facility can preempt state regulatory authority respecting that facility. The FERC has claimed that state commission authority over siting, environmental controls and similar things would not be affected,²⁸⁷ but one wonders, particularly about prudence.²⁸⁸ If an IPP is an interstate utility regulated by the FERC, would a state commission retain any jurisdiction over that facility? Would the state be limited to reviewing only the issue of whether there were prudent alternatives to a utility's IPP purchases?²⁸⁹

The FERC admits that rates for IPPs' sales to wholesale customers would be governed exclusively by the FERC, but that states would retain jurisdiction to review the prudence of a utility's decision to buy from the IPP as opposed to some other source under the *Pike County* doctrine.²⁹⁰ But, ironically, the FERC does not address the impact of its competitive bidding proposal. If a utility buys from an IPP under a qualified bidding program, would a state be able to examine the prudence of the purchase? Clearly, the answer is no, because one objective of the NOPRs is to reduce after-the-fact prudence reviews. And, if implementation of the NOPRs leads to a substantial reliance on IPPs, then existing state jurisdiction over generating resources would be significantly affected. A large number of FERC-jurisdictional transactions would displace generating arrangements that would otherwise be subject to state regulation. Again, given the FERC's unflattering assessment of cost-of-service regulation as heavy-handed and stifling of innovation, one must conclude that reducing the scope of regulation—which is currently, for the most part, regulation by state agencies—is a primary objective of the IPP and competitive bidding proposals. It is therefore disingenuous of the FERC to claim that its new IPP policy “would not alter the current division of jurisdiction” between state regulatory commissions and the FERC.²⁹¹

Superseding state jurisdiction over a large class of non-hydro and non-QF generators ventures into an area that has not been sanctioned by legislation. Indeed, it can be argued that regulation of generation facilities, other than hydroelectric dams and QFs, is an area that Congress chose to leave to the

Co., 36 F.E.R.C. ¶ 61,226 (1986); American Elec. Power Serv. Corp., 32 F.E.R.C. ¶ 61,363 (1985). But see American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n, 787 F.2d 588 (6th Cir. 1986); Kentucky Power Co. v. Kentucky Pub. Serv. Comm'n, No. 84-C1-1760 (D. Ky. Mar. 24, 1987).

286. Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986). See also Nixon and Johnston, *Nantahala Affirms Narrangansett—Whither Pike County?*, 8 ENERGY L.J. 1 (1987).

287. IPP NOPR, *supra* note 135, at 32,118.

288. Compare *Pike County Light & Power v. Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (Pa. 1983) (the FERC's approval of wholesale rate does not preclude state commissions from investigating prudence of purchase under that rate, in light of alternatives available to retailer) with *Nantahala*, 476 U.S. at 953 [and] *Appalachian Power Co.*, 812 F.2d at 898 (state commission lacks authority to review allocation of costs to state utility and rates for sales of power to state utility as set by the FERC).

289. See *Pike County*, 465 A.2d at 735; *Sinclair Mach. Prods., Inc.*, 498 A.2d 696 (N.H. 1985). See also *Arkansas Power & Light Co. v. Missouri Pub. Serv. Comm'n*, 829 F.2d 1444 (8th Cir. 1987) (state must pass the FERC-approved wholesale rate through to retail but need not do so “immediately,” i.e., outside of normal suspension and review procedures of state law).

290. IPP NOPR, *supra* note 135, at 32,118.

291. *Id.*

states. Section 201(b) of the FPA was drafted to preserve state jurisdiction over non-hydroelectric generating facilities by excepting "facilities used for the generation of electric energy" from the FERC's jurisdiction.²⁹² Decisions construing the scope of the FERC's jurisdiction under part II of the FPA have focused primarily on the "bright line" distinguishing wholesale transactions from retail transactions,²⁹³ but several decisions have implied that the FERC has no jurisdiction over thermal generating facilities.²⁹⁴ While there is an argument that section 309 of the FPA²⁹⁵ confers authority for the FERC to extend, by rulemaking, its jurisdiction over generation facilities otherwise exempted by section 201(b),²⁹⁶ the argument runs counter to the evident intent of the Federal Power Act as embodied in its legislative history.²⁹⁷

The obligation-to-serve issue cannot be disposed of merely by saying that utilities will only rely on IPPs to the extent they determine is consistent with their obligation to serve.²⁹⁸ If states and IPPs respond to the FERC's competitive bidding and IPP initiatives even half as enthusiastically as QFs responded to the PURPA, then utilities could form a very substantial dependence on IPPs. If an IPP went bankrupt, or refused to honor a supply contract for economic reasons, the utility it served would nevertheless retain an obligation to serve its franchise area and it might not have the capacity to fulfill that obligation. To be sure, the FERC may have authority to require jurisdictional utilities to continue service once it has been initiated, but that authority is untested.²⁹⁹ Moreover, while this authority might prevent breach of supply contracts (i.e., where an IPP willingly risks legal liability for higher rewards outside the contract), the FERC's jurisdiction might not prevent termination of service in accordance with an enforceable contract term (i.e., oil price con-

292. 16 U.S.C. § 824b (1982). See *First Iowa Hydro-Elec. Coop. v. FPC*, 328 U.S. 152, 171-75 (1946).

293. E.g., *FPC v. Southern Cal. Edison, Co.*, 376 U.S. 205, 215-16 (1964).

294. For example, in upholding the FPC jurisdiction over certain sales for resale, the Supreme Court, in construing sections 201(a) and 201(b) of the FPA has observed that "'production' . . . [is] elsewhere specifically excluded from Commission jurisdiction" by section 201(b). *United States v. Public Utils. Comm'n*, 345 U.S. 295, 310 (1953). In *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61, 72-73 (1943), the Supreme Court construed part II of the FPA as applying to (a) facilities used in transmission or sales at wholesale and (b) rates and charges for transmission or wholesale transactions, and indicated that there is a "distinction between the facilities for generation or production and those for transmission." In *Northern Cal. Power Agency v. FPC*, 514 F.2d 184 (D.C. Cir.), *cert. denied*, 423 U.S. 863 (1975), the court affirmed the FPC's ruling that it had no jurisdiction over a thermal generating facility.

295. 16 U.S.C. § 825h (1982).

296. The argument is that section 201(b) bars the FERC's jurisdiction over generation facilities except as authorized under subchapter III, and therefore a regulation under section 309 (part of subchapter III) would extend the FERC's jurisdiction to generation facilities.

297. The Senate's version of the bill that became part II of the Federal Power Act allowed the Federal Power Commission (FPC) jurisdiction over electric power generating facilities. S. REP. NO. 621, 74th Cong., 1st Sess. 19, 48-49 (1935). The House Committee rewrote the bill explicitly to prevent the exercise of such jurisdiction, and the House version of the bill prevailed in conference. H.R. REP. NO. 1318, 74th Cong., 1st Sess. 26-27 (1935); CONF. REP., H.R. REP. NO. 1903, 74th Cong., 1st Sess. 74 (1935).

298. IPP NOPR, *supra* note 135, at 32,118-19.

299. Norton and Spivak, *supra* note 96; Bouknight and Raskin, *Planning for Wholesale Customer Loads in a Competitive Environment: The Obligation to Provide Wholesale Service Under the Federal Power Act*, 8 ENERGY L.J. 237 (1987).

tingency). In any event, the reliability issue should be more carefully addressed once comments have been received.

Even if the FERC's authority is sufficient to require continuation of service, the IPP proposal complicates the enforcement procedure in the event of a deficiency. Which jurisdiction, state or federal, would assume responsibility and take appropriate action if a utility became capacity deficient? Would the FERC be called upon to enforce defaulted IPP contracts, or would the state commission be called upon to require a franchised utility to build or buy new capacity? It may not be an easy matter to apportion responsibility between the FERC and the state commissions in a situation of capacity deficiency, and each could hesitate to act in an emergency in deference to the other.

As in the case of competitive bidding, the FERC's authority to relax regulatory controls imposed under the FPA is open to question. There is no doubt that the broad public interest mandate of section 201 of the FPA applies to the transactions and procedures for which the FERC proposes waivers, blanket approvals and relaxed requirements.³⁰⁰ As the appeals court observed in *Farmers Union*, it is appropriate to relax regulatory oversight only where there is adequate assurance that the public interest will be protected.³⁰¹ In the NOPR, the FERC has proposed to relax broad regulatory controls over a class of electricity generators—IPPs—without any specific factual findings respecting that class of generators and without a record on which to base its assurance that the public interest will be protected. The FERC has not adequately explained how its foreshortened regulations would permit it to comply with the statutory requirements of the FPA.

Moreover, the FERC's proposed deregulation of IPPs is not consistent with the *St. Joe* and *Cliffs* decisions. In those decisions, the FERC was willing to deregulate generators that did not fit the traditional role of public utilities. The criteria developed in *Cliffs* focused on the extent to which an entity was performing a utility function. If application of those criteria to the facts of the situation indicated that the entity was performing as a traditional utility, then relaxing of regulations was not to be allowed. In the IPP NOPR, it was argued that IPPs should perform a traditional utility role, the supply of generation for sale to utilities. This is the very type of function specifically disallowed for one of the applicants in *Cliffs*. Yet, the FERC has not in its proposal addressed the direct conflict with this decision.³⁰²

The IPP proposal, like the competitive bidding proposal, is vulnerable to challenge on the grounds that it is inconsistent with both the PURPA and section 205 of the FPA. The IPP proposal is inconsistent with the policy of the PURPA to reduce reliance on oil and gas-fired generation. The FERC has

300. See *Gulf States Utils. Co. v. FPC*, 411 U.S. 747 (1973); *Connecticut Light & Power Co. v. Federal Power Comm'n*, 324 U.S. 515 (1945); *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61 (1943).

301. *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir.), cert. denied, 469 U.S. 1034 (1984).

302. To the extent the FERC relies on the financial plight of utilities as justification for deregulation, there is evidence that the industry's financial condition is not in jeopardy, but to the contrary is quite sound. See Kirsten, *Deregulation and Reorganization in the Electric Utility Industry*, 120 PUB. UTIL. FORT., Sept. 5, 1987, at 11. See also Trabandt dissent, *supra* note 5, at 32,075.

admitted that its IPP proposal would encourage the use of IPP facilities fueled by natural gas and light distillate oils.³⁰³ The PURPA also expressly deregulated qualified small power and cogeneration facilities, as defined by statute, and even declined to confer deregulated status on small power facilities between 30 MW and 80 MW. The PURPA therefore reflects an explicit decision on what types of facilities should be deregulated, implying that all others should not be deregulated. The FERC's decision to deregulate essentially all IPPs flies in the face of the distinctions concerning classes of facilities written into the PURPA by Congress.

The potential inconsistency of the IPP proposal with section 205 of the FPA is discussed in the competitive bidding analysis. In the IPP proposal, the FERC has relied on the price ceiling set at the purchaser's avoided cost rate as achieving compliance with the criteria of *FPC v. Texaco*. The use of such a ceiling is unprecedented because it is different for each utility and, in some cases, may be set unilaterally by the utility. In the latter case, the FERC promises to review the rate if it is challenged and to order refunds if appropriate.³⁰⁴ Whether this is a sufficient ceiling and provides sufficient consumer protection to withstand judicial scrutiny remains to be seen.

Two opinions relied on by the FERC for the justness and reasonableness of its IPP rate proposal lend little or no support to the FERC's position. The *Central Iowa* case³⁰⁵ involved a power pool agreement, a far different transaction than individual IPP generator sales, and also was a case in which a complete factual record concerning all facets of the transactions could be examined. And it is ironic that the FERC should cite *Farmers Union*. The *Farmers Union* court reversed the FERC's attempt to allow market forces to determine oil pipeline rates, rebuking the FERC's action as an "apologia for virtual deregulation."³⁰⁶

V. CONCLUSION

The FERC's competitive bidding and IPP proposals are fraught with problems. Taken together, these initiatives would largely deregulate the generation segment of the electric utility industry. The FERC has attempted to respond to PURPA implementation problems and to the reluctance of utilities to make capital investments in generating resources. But only its ADFAC proposal is fully justified by identified PURPA implementation problems. In view of the untried nature of competitive bidding, the FERC should allow states to continue to experiment with the concept, and the FERC itself should consider additional experiments, such as the experiment authorized by Opinion No. 203 and the WSPP experiment. With respect to IPPs, the FERC should continue the case-by-case approach reflected in the *St. Joe* line of cases, and perhaps consider a policy statement to synthesize the standards it has applied in those cases.

303. IPP NOPR, *supra* note 135, at 32,115.

304. *Id.* at 32,127.

305. *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156 (D.C. Cir. 1979).

306. *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984). See *supra* pp. 445-45.

Legal authority for both competitive bidding and IPP deregulation, as proposed by the FERC, is highly questionable. Competitive bidding must comply with section 210 of the PURPA, which was drafted to favor purchases of QF power over other sources. Allowing all sources to compete equally with QFs, even when QFs receive a preference on tie bids, may violate section 210. In addition, a wholesale electric power rate established through a competitive bidding process, or use of the proposed IPP rates, may not comply with the just and reasonable standard of section 205 of the FPA. Deregulation of IPPs, moreover, may violate section 201 of the FPA, and the FERC has not developed a record that would permit it to relax its IPP regulatory requirements imposed on jurisdictional utilities under other sections of the FPA.

Deregulation of the generation function raises many other unresolved questions. Deregulation could jeopardize a utility's traditional obligation to serve, and state/federal jurisdictional relationships could be profoundly affected. Much additional analysis should be done before competitive bidding and IPP deregulation are adopted.

As noted by Commissioner Trabandt, the FERC seems overly focused on economic theory, rather than concentrating on its statutory mandate to protect consumers:

Our responsibility at the Commission, pursuant to the Congressional delegation of statutory authority in the Federal Power Act, is to provide American consumers an assured and reliable electric power supply at the lowest reasonable costs. We, however, were not commissioned to use this nation's interstate electric power system to test new economic theories and regulatory concepts on a generic basis, as if that system was the world's largest micro-economic model. The Commission needs to get back to the basics under the Federal Power Act, and refocus its attention on the American consumer, rather than the primacy of economic efficiency in theory, so as to provide that assured and reliable supply at lowest reasonable cost.³⁰⁷

The FERC should heed Commissioner Trabandt's advice. In short, the FERC should adopt some form of the ADFAC proposal, but it should not implement the competitive bidding and IPP proposals.

307. Trabandt dissent, *supra* note 5, at 32,084.