Decision Creates Uncertainties

Federal Appeals Court Ruling Delays Course Of Cogeneration Plans with Electric Utilities

By William F. Cockrell
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COGENERATORS and electric utilities are carefully considering the implications of a Jan. 22, 1982 decision of the United States Court of Appeals for the District of Columbia.

The decision, *American Electric Power Service Corporation vs. FERC* ("American Electric"), invalidated the Federal Energy Regulatory Commission's (FERC) "full avoided cost" rule.

The rule requires the states to set rates for purchases of electricity from a qualifying cogenerator or small power producer facility built after the enactment of the Public Utility Regulator Act of 1978 (PURPA), legislation enacted by Congress in part to encourage the development of cogeneration and small-scale electric power production, at a level based on the utility's full avoided costs, or the cost for the utility to produce the additional power in-house or purchase it from another source.

Owners of cogeneration projects regard the full avoided cost rule as a major incentive to make interconnection arrangements with electric utilities.

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American Electric represents a victory for electric utilities. The decision may generate considerable uncertainty among state regulatory bodies in the process of reviewing electricity rates to cogenerators.

Utility commissions may well defer such reviews until FERC repromulgates its rules or exhausts legal appeals still available. (Recently the government filed a petition for rehearing in the *American Electric* case.)

Cogenerators are confronted with considerable uncertainty as to economic projections for cogeneration projects in that they can no longer assume that rates charged to utilities which purchase power from them pursuant to PURPA will be 100 percent of the avoided costs.

In fact, it seems clear that under the *American Electric* decision those rates will be less than 100 percent of avoided costs. Consequently, cogenerators must reassess present financial and contractual actions regarding interconnection arrangements with utilities.

American Electric was brought by a group of electric utilities who challenged the advantage given to cogenerators and small power producers under four FERC rules implementing Secion 210 of PURPA (which addresses cogeneration issues).

Another Ruling

In addition to vacating the full avoided cost rule the Court of Appeals overturned a regulatory provision which gives a blanket grant of authority to cogenerators to "interconnect" with utilities without meeting certain procedural requirements designed to protect utilities under the Federal Power Act, as amended and added to by Section 210 of PURPA.

The Court of Appeals upheld the remaining two of the challenged provisions:

- A rule allowing a cogenerator to engage in a "simultaneous purchase and sale" by which the utility is deemed to have purchased all of the cogenerated power, including that used by the cogenerator for its own power generation, and to have sold back to the cogenerator the power used by the cogenerator internally.
- A FERC decision not to invoke fuel use criteria in determining whether cogenerators are qualifying facilities under PURPA. (The commission had decided against limiting oil- and gas-fired cogeneration facilities.)

The *American Electric* court assailed the "full avoided cost" rule as undermining the goal of more equitable allocation among utilities and consumers of the costs saved by cogenerated power, and held that the uniform rule was promulgated "without convincing explanation" to support the imposition of the rule.

The court indicated that the avoided cost rule should be modified to contain an avoided cost level using less than the 100 percent standard and should contain a more detailed justification of its decision.

Court's Reasons

"It is clear that FERC has failed to meet its obligation to provide the public with the reasoned consideration, decision making, and opinion which it is required to give," the Court of Appeals stated.

"On remand we expect the commission to take a harder look at, especially, the percentage of avoided cost approach. Such an approach might, for example, entail FERC setting a specific percentage, or FERC might permit state commissions to set rates within a range — e.g., 80-100 percent — authorized by the commission."

Also struck down was the "interconnection rule" requiring electric utilities to interconnect with cogenerators to receive their power.

The court held that the rule directly violated those provisions of PURPA and the Federal Power Act, as added to and amended by PURPA, which require that FERC give notice and hold a hearing prior to ordering an interconnection and which require interconnections not to impair unduly utility reliability.

The court emphasized that any relief from these statutory procedural requirements must come from Congress.

Mandate Stayed

Despite the court's opinion, the FERC's full avoided cost and interconnection rules legally remain in effect. The FERC has filed a petition with the court for a rehearing, an action which stays any order or mandate implementing the court's Jan. 22 opinion.

Should the court decline the FERC's petition for rehearing — or grant it and rule against the agency a second time — the FERC may further delay the court's mandate invalidating the rules while the decision is being appealed to the Supreme Court.

If FERC's pursuit of these legal avenues is ultimately unsuccessful — which is likely — the agency must repromulgate in a new rulemaking proceeding rules in accordance with the Court of Appeal's decision.

In that event, cogenerators and utilities can be expected to participate vigorously in the proceeding, in view of the court's invalidation of the full avoided cost rule and due to what appears to some observers to be a reluctance on the part of the Reagan administration to support fully cogeneration and small-scale power production activities under Section 210 of PURPA.

In another proceeding involving a challenge to PURPA, the Supreme Court in the next several months is expected to issue its decision in *FERC v. The State of Mississippi*, in which certain statutory provisions of PURPA, including Section 210, have been challenged as unconstitutionally interfering with the traditional role of states in regulating retail rate structures and service practices of electric utilities.

PURPA was enacted on Nov. 9, 1978, as part of the National Energy Act of 1978, a five-part comprehensive energy policy package designed to provide federal incentives that would address energy problems on all fronts.

PURPA, a major component of the package, was intended to achieve three stated purposes: 1) to foster conservation by the ultimate end-user of electricity; 2) to maximize the efficiency of use of facilities and resources by electric utilities; and 3) to encourage the establishment of equitable rates to consumers with electricity priced at the true cost of providing service to each class of consumers.

PURPA empowers the Department of Energy (DOE) and FERC to regulate the wholesale distribution of electricity and to monitor the activities of small hydroelectric power projects and crude oil transportation systems, and alters utility ratemaking under existing state regulations by stepping up federal involvement in that process. The primary responsibility for utility ratemaking, however, remains with the states and not the federal government.

The regulations challenged by the electric companies in *American Electric* were promulgated by the FERC in a Feb. 19, 1980 rulemaking under Section 210, PURPA's provision concerning "cogeneration and small power production."

A cogeneration facility simultaneously produces two forms of useful energy, electric energy and thermal energy, such as heat or steam. A small power production facility uses waste, biomass, or renewable resources, including wind, solar and water, to produce electric power.

The aim of Section 210 is to reduce the nation's reliance on traditional fossil fuels through conservation measures requiring the cooperation of electric utilities with small producers.

Congress designed Section 210 to facilitate the use of cogeneration and small power production facilities by requiring electric utilities to purchase available electric energy from such "qualifying" facilities under Section 201 ("Definitions") of PURPA at nondiscriminatory rates and by requiring the utilities to provide electric service to qualifying facilities at rates which are just and reasonable, in the public interest, and which do not discriminate against cogenerators and small power producers. Section 210(e) also permits the FERC to exempt qualifying facilities from state regulation regarding utility rates and financial orginizations.

Sections 201 and 210 of PURPA mandate that FERC prescribe such rules as it determines are necessary to encourage the use and installation of cogeneration and small power production facilities.

To implement Section 210, FERC promulgated regulations requiring electric utilities to purchase electric power from and sell electric power to qualifying cogeneration and small power production facilities, and providing for the exemption of qualifying facilities from certain federal and state regulation.

Implementation of the rules was reserved to the state regulatory authorities and nonregulated electric utilities. The regulations became effective March 20, 1980.

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