PURPA: THE INTERSECTION OF COMPETITION AND REGULATORY POLICY

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I. INTRODUCTION

High on the priority list of matters to be considered or reconsidered by the present Congress is the "reform" and possible repeal of section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA).[1]

This issue has been given immediacy by a landmark decision of the Federal Energy Regulatory Commission (FERC) disapproving of a PURPA order of the California Public Utility Commission (California Commission), which had required certain utilities to purchase PURPA capacity they thought unnecessary at prices they believed too high.[2]

Proponents of measures to modify or kill PURPA suggest that the statute has been overtaken by events—principally by the push for a more competitive marketplace in electric power generation.[3] PURPA opponents further complain that the law has inordinately boosted consumer costs.[4] They suggest that this country's energy landscape has markedly changed; that the concerns about scarcity which once drove regulatory thinking no longer exist.[5] Accordingly, critics of the statute agree that radical change is in order. Some opponents have, as a preliminary step, requested modification of some of the FERC's implementing regulations and procedures.[6]

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1. 16 U.S.C. § 824a-3(h) (1988). In addition, several petitions for rulemaking have been filed with the Federal Energy Regulatory Commission (FERC) for changes in regulations or in regulatory practice under section 210 of PURPA. *See generally* Petition of the PURPA Reform Group to Initiate Rulemaking to Repeal the PURPA Lock-In Rule, May 24, 1995 [hereinafter *PURPA Reform Petition*]; Petition of the Edison Electric Institute (EEI) for a Rulemaking Regarding Implementation of the Public Utility Regulatory Policies Act of 1978 in the Context of the Energy Policy Act of 1992, June 2, 1995 [hereinafter *EEI Petition*].

2. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, *recons. denied*, 71 F.E.R.C. ¶ 61,269 (1995).

3. *See EEI Petition*, *supra* note 1, at 10.

4. The EEI estimate of PURPA excess cost to consumers is $38 billion. *EEI Petition*, *supra* note 1, at 4.

5. *See* PURPA REFORM GROUP, POLICY PAPER 11 (undated) (on file with author) [hereinafter *PURPA Policy Paper*] ("The energy crises of the 1970s, which led to the enactment of PURPA, are long gone.").

6. The PURPA Reform Group, an association of utilities, seeks repeal of the "lock-in" rule, which, it asserts, provides for "locking-in" capacity or energy charges based on inflated fuel price estimates and too-high demand forecasts. *PURPA Reform Petition*, *supra* note 1, at 1-2.

Led by numerous electric utilities, critics have mounted a campaign in support of Senator Don Nickles' proposal to repeal section 210 of PURPA.[7]

This article will suggest an alternative view: that the values advanced by PURPA remain valid and important and continue to deserve support. Energy conservation is one of the best examples; quite apart from the economic impact of conservation efforts, the need to husband resources is a fundamental prudential or ethical value. This is especially significant when America retains its high standing in wastefulness among advanced industrialized countries.[8] Also of importance is the need to diversify generation against the risks of an uncertain future and to continue the development of non-fossil fuel generation. PURPA's detractors have largely failed to discuss whether these values remain important, and, if so, how they should be furthered if section 210 of PURPA is scrapped. Only if these values can otherwise receive continuing attention and support is it appropriate to dismantle the PURPA machinery.[9]

In addition, this article is concerned with the intersection between PURPA's policies and the developing competition in the electric utility industry—in particular, whether unconstrained competition in the market for electricity will further the policies of section 210 of PURPA that still seem important. This question is timely because a number of observers, including the FERC's chairperson, seem to be suggesting that with "full" or "workable" or possibly "perfect" competition, PURPA may be redundant; its goals, in this view, will either be achieved by competition or, it may be inferred, they should be abandoned.[10] Even spokespersons for the independent power industry seem to concede this, perhaps reflecting the degree to which deregulation and a proper obeisance to competition have become politically correct.[11] This article takes sharp issue with this view, maintaining that, even under conditions of workable competition, some of PURPA's goals may be lost if left solely to the marketplace. I suggest that

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7. Senator Don Nickles has proposed the repeal of PURPA section 210 in "The Electric Utility Ratepayer Act." S. 708, 104th Cong., 1st Sess. (1995). *See also infra* note 58.

8. Apparently, the United States is a close second to Canada as the most energy-wasteful industrial country. CHRISTOPHER FLAVION & ALAN DURNING, WORLDWATCH PAPER NO. 82: BUILDING OF SUCCESS: THE AGE OF ENERGY CONSERVATION, at 8 (1988).

9. This proposition seems consistent with the position of the National Association of Regulatory Utility Commissioners (NARUC) on PURPA's mandatory purchase requirement. *See* NARUC Resolution on Legislation to Reform Section 210 of the Public Utility Regulatory Policies Act of 1978 (July 26, 1995) (on file with author) [hereinafter *NARUC Resolution*].

10. Lori A. Burkhart, *Lawmakers Target PURPA for Repeal,* PUB. UTILS. FORT., July 1, 1995, at 17.

11. *See* The 1995 Electric Executives' Forum: *PURPA: Reform or Repeal?*, PUB. UTILS. FORT., June 1, 1995, at 30 [hereinafter *Electric Executives' Forum*] (remarks of B. Jeanine Hull regarding her view of proposed PURPA reform). The NARUC Resolution contains the following language: "PURPA's mandatory purchase requirement shall not be applicable in any state which has made a finding that the acquisition of generating capacity is subject to competition or other acquisition procedures such that the public interest is protected with respect to price, service, reliability and diversity of resources." *NARUC Resolution, supra* note 9, at 2. This language suggests a belief that competition as such also protects diversity of resources—not a clear proposition.

both fuel diversity and energy conservation might be completely ignored if the only emphasis in evaluating generation is on current market price.

II. PURPA: Its Genesis and Disfavor

A. *The Birth of PURPA*

PURPA was Part V of the National Energy Act (NEA), all of which was born of the energy experience of the 1970's. Then, dramatic and severe shortages of oil and natural gas and skyrocketing prices of almost every form of energy prompted public concern.[12] Because the United States had been hurt by the Arab oil embargo interdicting supplies from the Middle East, a dominant purpose of the NEA and of PURPA was to further our country's energy self-sufficiency. There was an intense desire to reduce dependence on foreign oil (and on fossil fuels generally) and to diversify technologies used for the generation of electricity.

To this end, PURPA encouraged energy conservation and energy efficiency through measures such as cogeneration.[13] Another important PURPA goal was to stimulate the development of generation of electricity from renewable resources. These renewable resources, such as solar power, wind power, biomass and geothermal energy, had a number of attractive features. Primarily, these "non-traditional" energy sources were not depletable. They were also relatively benign in their impact on the environment.[14] The substitution of renewable energy sources for fossil fuels had a particularly strong appeal in the 1970's because of the painful scarcity of oil and natural gas and environmental and safety objections to coal and nuclear power.[15] In addition, powerful environmental arguments now support the limitation of fossil fuel combustion—such arguments often focusing upon the "greenhouse effect."[16] As the problems of the 1970's unfolded, domestic energy sources were favored and domestic

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12. Steven R. Miles, *Full-Avoided Cost Pricing Under the Public Utility Regulatory Policies Act: "Just and Reasonable" to Electric Consumers?*, 69 Cornell L. Rev. 1267, 1283 n.99 (1984).

13. The thermal efficiency of central station power plants is generally less than 40%, while that of cogeneration facilities may be as high as 60% to 80%. As of 1980, the overall fuel efficiency of the United States utility network was 29%. F. Paul Bland, *Problems of Price and Transportation: Two Proposals to Encourage Competition From Alternative Energy Sources*, 10 Harv. Envtl. L. Rev. 345, 347 n.19 (1986). Stanley A. Martin, *Problems With PURPA: The Need for State Legislation to Encourage Cogeneration and Small Power Production*, 11 B.C. Envtl. Aff. L. Rev. 149 (1983).

14. Murray Silverman & Susan Worthman, *The Future of Renewable Energy Industries*, Elec. J., March 1995, at 12, 27 ("[It has been estimated] that explicit recognition of externalities would add 4-8 cents per kilowatt hour to the cost of electricity generated by fossil fuels. If [these] estimates are valid, many renewables would not only be competitive with fossil fuels, they would be the low-cost generation option.").

15. Commentators such as Amory Lovins advocated reliance upon renewable energy sources (primarily as an alternative to nuclear energy). *See generally* Amory B. Lovins, Soft Energy Paths: Toward A Durable Peace (1977).

16. *See* Bill McKibben, *Not So Fast*, N.Y. Times, July 23, 1995, at 24 ("The Intergovernmental Panel on Climate Change, a group of scientists assembled by the United Nations, has calculated that an immediate 60 percent reduction in fossil fuel use is necessary to stabilize global climate."). *See also* William K. Stevens, *Global Warming Experts Call Human Role Likely*, N.Y. Times, Sept. 10, 1995, at 1, 6.

sources having environmental and conservational advantages were especially favored. Hence, section 210 of PURPA.

As noted, the statute contained measures that encouraged cogeneration and facilitated the entry of renewable energy sources into the market. A major problem confronting both cogeneration and energy from renewable sources was that the electric utilities comprised almost the only market for electricity from these alternative energy sources. And the utilities, for various reasons—including cost—were reluctant to purchase power from their potential competitors. If the utilities in fact agreed to purchase, the prices they offered were not attractive. There was also a problem of discrimination by utilities in furnishing electricity (primarily standby and back-up power) to alternative energy installations. Section 210 of PURPA therefore established a rule requiring the utilities to buy power from a qualifying small power production facility which had a capacity of 80 megawatts or less, as well as from a qualifying cogeneration facility (together Qualifying Facilities or QFs). The price of PURPA power, as prescribed by statute and interpreted by regulation, was full-avoided cost,[17] or the cost to a utility of generating the same energy or purchasing it from another source.

The statute's success can be gauged by surveying the current energy landscape.[18] The situation of alternative energy is mixed but improving: Cogeneration has made dramatic strides, but the progress of renewables is more modest. Thus, in contrast to 1978 when PURPA was enacted, nontraditional producers, including QFs under PURPA, currently provide more than half of all new generating capacity.[19] PURPA sources now account for more than 5% of the total United States' generating capacity.[20] But, looking at the picture in greater detail, the development of cogeneration facilities has been almost three times as great as the growth of small power production facilities using renewable resources.[21] Moreover, the predominant form of cogeneration has involved the combustion of natural gas.[22] Some observers have noted that "[i]n spite of the fact that

17. *See* 16 U.S.C. § 824a-3(b)-(d) (1994); 18 C.F.R. § 292.101(b)(6) (1995).

18. More might be said about a number of PURPA's specifics, for example: whether the size limitation on small power production facilities is appropriate; whether cogeneration requires promotion to the same extent as renewables do; and so on. These possible issues have not, however, so far been the subject of much discussion and are generally beyond the scope of this article.

19. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,675.

20. *Compare* Alfred E. Kahn, *Deregulation: Looking Backward and Looking Forward*, 7 YALE J. ON REG. 325, 327 n.9 (1990) *with* Brent L. Vanderlinden, *Bidding Farewell to the Social Costs of Electricity Production: Pricing Alternative Energy Under the Public Utility Regulatory Policies Act*, J. CORP. L., Summer 1988, at 1034-35. *See also* Mason Willrich, *A Vision of the Future*, PUB. UTILS. FORT., Oct. 1, 1991, at 12.

21. Vanderlinden, *supra* note 20, at 1034-35.

22. *Id. See also Orange and Rockland Utils., Inc.*, 43 F.E.R.C. ¶ 61,067, 61-199-212 (1988) (Salon, Comm'r, concurring). Natural gas cogeneration, of course, involves fossil fuel combustion and contributes to the greenhouse effect (although only half as much as coal). Ellyn R. Weiss & James Salzman, *The Greening of American Energy Policy*, 63 ST. JOHN'S L. REV. 691, 705 (1990). Ironically, the predominance of natural gas-fueled cogeneration seems inconsistent with the purpose of PURPA to reduce dependence on oil and natural gas.

lawmakers and activists have called for the use of renewables nationwide, grid-connected renewable electric capacity (if large scale hydro is factored out) is less than 3 percent of total U.S. capacity."[23] There is general agreement that the price of renewables has become more competitive throughout the period PURPA has been in force.

B. The Call for Reform

What is it that currently makes section 210 of PURPA a target for repeal or at least drastic revision? First, PURPA has succeeded, and renewables and cogeneration have become a significant part of electric energy production in this country, although their share, as has been indicated, is still less than 10% (with renewables less than 3%). Second, and undoubtedly most important, the movement for a competition-driven electric utility industry has gained a great deal of momentum and, in some quarters at least, PURPA is thought to be anti-competitive. For example, one author queries:

> If . . . a market is artificially created (as was PURPA cogeneration and small power production), how can its operation be said to prove anything regarding economic theory. In fact, it seems entirely contrary to basic theory because the rules . . . of a government[-]established market are not created by the market itself, but are rather established exogenously by a non-market entity—the government.[24]

In addition, the PURPA Reform Group, an association of utilities, has stated that "PURPA is not a procompetitive statute. PURPA is a regulatory statute designed to reduce the use of fossil fuels in the generation of electricity."[25] A related objection, voiced very generally by investor-owned utilities, is that PURPA power is not needed and is, even when needed, over-priced (in excess of full-avoided cost)—a combination which unjustifiably increases consumer cost. These purportedly undesirable aspects of PURPA power have their origins in erroneous forecasts of the late 1970's and early 1980's, which anticipated high fuel prices and rapidly growing demand for power. These expectations allegedly resulted in excessive prices for PURPA energy and capacity that was not, in any event, needed.[26]

Third, the belief that "soft energy paths" need to be followed for the sake of the environment or that fossil fuels need to be conserved (and deemphasized) through the use of renewables has lost its force.[27] In addition, the more recently articulated concern that fossil fuel combustion con-

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23. Silverman & Worthman, *supra* note 14, at 12.

24. Robert L. Swartwout, *Current Utility Regulatory Practice from a Historical Perspective*, 32 NAT. RESOURCES J. 289, 328 (1992) (citations omitted).

25. *PURPA Reform Petition*, *supra* note 1, at 3.

26. Blair G. Swezey, The Regulatory Outlook for Renewable Electric Generation in the U.S., Address Before the Advanced Workshop in Regulation and Public Utility Economics, Sixth Annual Western Conference 10 (July 7-9, 1993) (on file with author) ("The slower electricity demand growth of the late seventies and early eighties, coupled with the completion of many large base load power plants, left many utilities with surplus capacity.").

27. *Id.* at 5 ("federal energy policies have become less supportive of renewable energy developments [since the 1980s].").

tributes to the greenhouse effect seems to receive little weight in the PURPA analysis.[28] Even conservation of energy by cogeneration does not at the moment appear to be a matter of central concern.[29] Although these changes in sentiment seem to motivate much of the call for reform, a few voices have suggested the possibility that another oil shortage might loom in the future, presumably attended by circumstances like those that inspired PURPA in the first place.[30]

Also bearing on the PURPA debate has been the "bubble" (surplus) in natural gas,[31] currently regarded as the "good" fossil fuel. Natural gas is relatively cheap and is the most environmentally benign of the fossil fuels used for electric generation. It is utilized by plants that can be constructed quickly and without vast demands for capital. It is burned in combustion turbines—preferably the combined-cycle gas turbine. Although, as already noted, natural gas has figured prominently in PURPA applications, it is expected to be a much bigger factor in a broader competitive context (largely because it is presently so cheap and plants employing it are so easy to build). There is therefore a tendency to think of PURPA as irrelevant to a future dominated by natural gas-fueled generation. It is ironic that PURPA cogeneration has focused on developing an energy source that provides a basis for arguing that PURPA is no longer necessary, but this seems to be what is happening.

A major factor that inspires the demand to "move beyond" PURPA is the passage of the Energy Policy Act of 1992 (EPAct).[32] That statute has created a new category of independent production facilities to operate in the wholesale market. These "exempt wholesale generators" (EWGs) are, as the name implies, exempt from the Public Utility Holding Company Act.[33] EWGs are not limited as to size, renewable energy source or cogeneration, nor are any other PURPA constraints imposed.[34] In addition, they may be utility owned.[35] It is anticipated that many EWGs will be natural gas-fired. Again, from the viewpoint of PURPA's critics, the EPAct's incorporation of competitive policies seems to render PURPA outdated.

All of these considerations are behind the push for reform. But reform efforts notwithstanding, attention must be paid to retaining those

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28. *See, e.g.*, McKibben, *supra* note 16, at 24.

29. Cogeneration is an old technology—predating central station generation. In many instances, electricity was originally a by-product of process steam.

30. Irwin Stelzer, *America Drives Into the Grasping Hands of Opec*, LONDON TIMES, July 2, 1995, at 2-12. *See also* Kahn, *supra* note 20, at 339 ("It seems likely . . . that the present large natural gas supply bubble will be exhausted during the 1990s, resulting in a sharp increase in the field price.").

31. *Orange and Rockland Utils., Inc.*, 43 F.E.R.C. ¶ 61,067, at 61, 199-212 (Salon, Comm'r, concurring). *See also* Kahn, *supra* note 20, at 339.

32. *See EEI Petition*, *supra* note 1, at 3. *See also* Energy Policy Act of 1992 (EPAct), Pub. L. No. 102-486, 106 Stat. 2776, 2905-21 (codified at 42 U.S.C.A. §§ 13201-13556 (West Supp. 1993)).

33. 15 U.S.C. § 79z-5a(e) (1994).

34. *Id.* § 79z-5a(h).

35. *See* Phillip S. Cross, *Cogeneration: Growing Risk in a Complex Market*, PUB. UTILS. FORT., Dec. 1, 1992, at 39.

goals—first clearly enunciated by Congress—that still remain relevant and important.

III. PURPA Policy and the Interplay With Competition

A. PURPA As An Introduction to Competition

PURPA has always advanced *some* of the benefits yielded by a competitive marketplace. From one perspective, for instance, PURPA is hailed as the measure introducing competition into the electric utility industry and thereafter aggressively advancing it. This is because under PURPA, utilities have been required for the first time to buy power from non-utility sources, sources directly competitive with the utilities' own generation, and to use this power to provide service to customers.[36] The aura of competition was also greatly enhanced by the introduction of competitive bidding as the preferred process for awarding long-term PURPA contracts.[37] This procedure establishes not only the price to be paid, but also (and more significantly) which facilities are to win a contract.[38] As certain observers have pointed out, this has been competition *for* a market, rather than competition *within* a market.[39]

The competitive "catch" to PURPA was, of course, that the obligation to buy, as well as the price, was statutorily and administratively constrained—not the result of voluntary market participation. PURPA's advocates believed that utility reluctance to admit wholesale competition justified this intervention. But by the same token, one can hardly call these workings those of a free market—even if competitive bidding is employed.

Nevertheless, PURPA introduced competitive generators into the electric marketplace, but it did so on the wings of a regulatory intervention. Reformers, as noted, are now balking at the burdens imposed by this intervention, though without undertaking a comprehensive examination of PURPA's policies and their place in an unconstrained marketplace. Such an analysis is now urgently required.[40]

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36. This obligation to purchase alternative power is limited by at least two crucial conditions, however. One is the actual need for power (usually as determined by a state advance resources plan). Another is the just and reasonable purchase price that reflects no more than the full-avoided cost of either building utility generation capacity to supply power or buying power from another source.

37. Competitive bidding, as opposed to solely administrative computation of avoided cost, has increasingly become the norm in recent years.

38. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,677.

39. *See* Douglas Gagax & Kenneth Nowotny, *Competition and the Electric Utility Industry: An Evaluation*, 10 YALE J. ON REG. 63, 82-84 (1993).

40. NARUC has urged comprehensiveness and deliberation in evaluating PURPA, stating: "PURPA is but one piece of [a] . . . larger puzzle, and accordingly, Congress should not examine the issue in isolation from . . . other developments." *Alternative Power Purchase Requirements for Utilities, 1995: Hearings on S.708 Before the Subcomm. on Energy Production and Regulation of the Senate Comm. on Energy and Natural Resources*, 104th Cong., 1st Sess. (1995) (prepared statements of Bob Anderson, Commissioner of Montana Public Service Comm'n and President of NARUC) (on file with author) [hereinafter *NARUC Testimony*].

B. Are PURPA's Policies Out of Date?

PURPA's commitment to conservation and fuel diversity are relevant even amid today's apparent abundance of fuels. The relevance of these objectives may be obscured by the arrival of competition as a claimed solution to all the problems of the industry. But the simple, common-sense virtue of conserving energy or of reducing dependence on fossil fuels—particularly those of foreign origin—speaks for itself. Waste is never sound policy and, even in the post-Soviet world, self-sufficiency reduces risk. Some suggest that changed conditions—notably the seeming surplus of natural gas—justify moving away from these concerns. But there is no guarantee against the return of 1978 conditions and the energy dependencies associated with them.[41]

Even if shortage risks are remote, diversity of energy sources is still important. Diversity provides the only available insurance against unfavorable outcomes of unforeseeable origin. If past experience teaches anything about fuel choices, it is that the business of making forecasts is exceedingly chancy. The only predictable quality of energy forecasting has been its unpredictability.[42] Considering the frailties of forecasting, the "not all your eggs in one basket" principle seems the beginning and the end of wisdom.

The example of the 1970's is, in this regard, horrific. Natural gas, believed to be in permanent shortage, was drastically limited for use in electric generators.[43] Oil and gas prices were thought to be headed for the stratosphere. At the same time, most industry witnesses testified (and many regulators believed) that the demand for electric energy was inelastic: users needed electricity and would not be discouraged by rising prices.[44] Only some environmentalists—certainly not "experts" and definitely not the majority—thought consumers would respond to price increases by curbing consumption. Perhaps their wish was father to the thought, but events later proved this minority correct.

The wayward nature of these energy forecasts revealed the fallibility of both regulators and industry. If the alarming wisdom of the 1970's had been vindicated, the price of oil would now be at least $100 per barrel[45] and natural gas would be on the endangered list. The spectacular failure of these predictions may in part explain the current popularity of markets—

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41. *See* Stelzer, *supra* note 30.

42. *See generally* Michael C. Lynch, *Future Oil Supplies: Is Wolf Really at Door?*, 7 F. FOR APPLIED RES. & PUB. POL'Y 23 (1992) (discussing the diffictulty in forecasting energy supplies).

43. Power Plant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289 (repealed 1988).

44. " 'From 1973 to 1982, the Edison Electric Institute, the nationwide association of investor-owned utilities, overestimated projected demand by more than 100 percent every year.' " Vanderlinden, *supra* note 20, at 1016 n.54 (quoting D. MORRIS, BE YOUR OWN POWER COMPANY 22 (1983)). *See also In re Madison Gas & Elec. Co.*, 5 Pub. Util. Rep. 4th (PUR) 28, 58-60 (Wis. Pub. Serv. Comm'n 1974) (Padrutt, Comm'r, dissenting).

45. Lynch, *supra* note 42, at 23-24.

which purportedly discount the future and render conscious prediction unnecessary. Markets, however, are not notable for *long-term* foresight.[46]

In any event, contrary to some assertions, Congress has reiterated its commitment to the goals reflected in PURPA—as well as related regulatory objectives.[47] The EPAct, primarily because of its wheeling provisions and the creation of EWGs, is properly invoked as an example of the congressional commitment to competition. This legislation, however, also requires states to consider "integrated resource planning"; this involves an evaluation of cogeneration and renewable energy resources.[48] In addition, the EPAct provides that rates should be set at levels that will encourage utilities to make investments in demand-side management.[49] This, of course, evidences a renewed commitment to energy conservation.[50] In fact, the breadth of other regulatory subject matter that the EPAct addresses—all of it consistent with section 210 of PURPA—is extraordinary.[51]

PURPA, as thus amended and supplemented by the EPAct in a fashion entirely consistent with the thrust of section 210, merely "represents a [c]ongressional judgment that the government should participate in selecting which technologies our society will rely on to meet our electricity needs."[52] Although less obvious than promoting energy conservation, reducing reliance on foreign fuels and recognizing environmental goals, there may also be reliability benefits in having small, dispersed qualifying facilities throughout a state or region. If these facilities provide the same amount of power as a single large utility plant, the unfortunate possibility

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46. The consequence of market competition will be, it is hoped, cheap electricity. There is some irony in the fact that sixty years ago, the same objective—cheap electricity—inspired giant government-owned power projects like the Tennessee Valley Authority and the Bonneville Power Authority, the polar opposite of free market competition among private actors.

47. *See, e.g.*, Environmental Action, Inc. v. FERC, 939 F.2d 1057, 1061 (D.C. Cir. 1991) (noting that "such advantage as a QF may have stems directly from the Congress's policy choice to encourage the sale of power by QFs rather than by traditional utilities."). The court also noted that a move by the FERC to place QFs on an equal commercial footing with competing suppliers would "effect an administrative repeal of this congressional choice . . . ." *Id.* at 1062.

48. *See* 16 U.S.C. § 2602 (1994).

49. *Id.* § 2621(d)(8).

50. *See, e.g.*, James W. Moeller, *Electric Demand Side Management Under Federal Law*, 13 VA. ENVTL. L.J. 57, 81 (1993).

51. One author has noted that:

> The various titles [of EPAct] deal, among other things, with energy efficiency, natural gas, alternative fuels, electric motor vehicles, electricity, high level radioactive waste, the United States Enrichment Corporation, remedial action and uranium revitalization, uranium enrichment health, safety, and environment issues, renewable energy, coal, strategic petroleum reserve, octane display and disclosure, global climate change, oil pipeline regulatory reform, general provisions; reduction of oil vulnability [sic], energy and environment, energy and economic growth, coal, oil and gas, Indian energy resources, insular areas energy security, and nuclear plant licensing.

Matthew Holden, Jr., The Electric Utility Industry: Regulation, Competition, and Restructuring 33-34 (1995) (citations omitted) (unpublished manuscript, on file with author). Professor Holden is the author's former colleague at the Wisconsin Public Service Commission.

52. Bland, *supra* note 13, at 383.

of a big plant failure can be avoided.[53] In the same vein, small increments to power supply may help avoid "rate shock," resulting from the sudden addition of large, expensive plants to the rate base.[54]

Admittedly, some significant progress has been made in developing alternative sources of electric generation, although renewables still represent less than 3% of the national total. PURPA has been more successful than its authors anticipated.[55] We now have a reality test of "soft energy paths"—the renewable technologies advocated by Amory Lovins[56] and others—that was not available in 1978. And an argument can be made that renewable energy and conservation should now stand on their own competitive feet. If they have anything to offer, perhaps the market will "work its magic" in their behalf. If, on the other hand, their virtues are only academic and their benefits unsustainable in the real world, they will continue to occupy their own little island and will fail to secure a larger place in the energy world. Although this conventional competitive analysis seems to have been widely accepted, it suggests that any worthy policy will "automatically" receive due recognition in the market—that the competitive result is by definition the best of all possible worlds.[57]

C. PURPA: The Interplay with Competition

The crux of a PURPA analysis must therefore be at the point where its policies intersect competition. Is PURPA in its present form anticompetitive? Would its policies be furthered or derailed by an unmanaged competitive process? If its policies failed the competitive test, does this mean that those policies are unworthy? Or does it mean that competition does not advance all the important policies that are desirable for the electric power system?

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53. Bland, *supra* note 13, at 366 (quoting page 16 of the Nov. 15, 1985 Application of the Virginia Elec. & Power Co. to Revise Rate Schedule 19 (Final Order, Case No. PUE 830067, Va. State Corp. Comm'n)). Some analysts, however, question the theory that small plants can be efficient. They suggest instead that in primary coal technology, scale economies in construction are not outstripped by availability problems in plants with capacity of up to 700 megawatts. *See* Gagax & Nowotny, *supra* note 39, at 70.

54. *See* Charles G. Stalon & Reinier H.J.H. Lock, *State-Federal Relations in the Economic Regulation of Energy*, 7 YALE J. ON REG. 427, 448-49 (1990). Additional benefits from PURPA sources may be that most alternative energy sources (such as a number of solar sites and most cogeneration) tend to be located closer to consumers, thus reducing line losses and distribution costs. Alternative generation may also carry with it the prospect of creating more jobs. Bland, *supra* note 13, at 364-65.

55. Blair G. Swezey, The Current Status of Renewable Electric Generation in the U.S.: Deployment, Economics, and Policies, Address Before the NARUC-DOE Fourth National Integrated Resource Planning Conference 3 (Sept. 13-16, 1992) (unpublished manuscript, on file with author) ("PURPA proved much more successful at encouraging alternative power development than originally envisioned.").

56. *See generally* LOVINS, *supra* note 15.

57. This is the policy corollary to the proposition of constitutional law, contained in *Lochner v. New York*, 198 U.S. 45 (1905), that regulatory intervention in market processes violated substantive due process. *See* Richard D. Cudahy, *Retail Wheeling—Is This Revolution Necessary?*, 15 ENERGY L.J. 351, 359-62 (1994).

A good bit of the commentary on PURPA, including arguments made in its defense, seems to assume that in a perfectly competitive world, PURPA, as a regulatory intervention, would no longer be "necessary."[58] It is not clear whether this means that PURPA's goals would be advanced by unconstrained market competition or that the market will simply sort out modes of generation according to its own values. If these values corresponded with those of PURPA, so much the better. If they did not, too bad for PURPA—PURPA would then be the first lamb slaughtered on the altar of competition. This sort of analysis more clearly reflects the frailties of thinking about competition than it does the frailties of PURPA.[59]

The purported benefits of PURPA are long-term and intangible. Ostensibly, by diversifying generation, PURPA lessens the risk of a shortage (as with natural gas, circa 1977) or of an unforeseen problem with a particular mode of generation (as with nuclear, circa 1980). Supposedly, PURPA, by promoting natural gas and non-fossil fuel generation, diminishes the burden of acid rain and greenhouse gases. In principle, PURPA lessens the demand for coal, with its documented pollution problems and the attendant safety and environmental problems associated with coal mining; it also reduces the need to import oil from parts of the world threatened with political instability. Obviously, these and other benefits cannot easily be quantified or reduced to present value.[60] They are benefits that the market, for the most part, views with indifference.[61] In fact, the more successfully they can be ignored, the better for the market price of power. With respect to these values and considerations, the Invisible

58. For a discussion of PURPA that includes such commentary, see *Electric Executives' Forum*, *supra* note 11. PURPA does, however, have its defenders, although even these proponents seem to accept the view that a more perfect competition may eliminate the need for such regulatory measures. *See, e.g.*, *Electric Executives' Forum*, *supra* note 11, at 30 (remarks of B. Jeanine Hull). *See also NARUC Testimony*, *supra* note 40, at 3-4; W. Lynn Garner, *EGA's Hull: Survival Is Our Goal*, PUB. UTILS. FORT., Apr. 15, 1995, at 35.

59. In its testimony prepared for presentation to the Senate Committee considering repeal of PURPA, NARUC seemed to equate "full" competition with regulatory advancement of PURPA's goals. Thus, NARUC stated that "PURPA should be repealed only if (1) the electric generation market is fully competitive—it's not, or (2) it is replaced with something better which embodies the original public policy goals of PURPA." *NARUC Testimony*, *supra* note 40, at 3-4. This scheme of alternatives is puzzling.

60. One commentator has stated:

> Many data needed for reliable cost-risk-benefit analysis are not just unknown[,] but unknowable in principle. For example, few social scientists would claim they can calculate the probability that malevolent persons will sabotage a reactor, build an atomic bomb, or blow up a liquified natural gas (LNG) tanker. Nevertheless, such probabilities are used routinely in cost-risk-benefit assessments.

Amory B. Lovins, *Cost-Risk-Benefit Assessments in Energy Policy*, 45 GEO. WASH. L. REV. 911, 925 (1977). *See also* Silverman & Worthman, *supra* note 14, at 13 ("In this broader industry [of utilities and large independent developers], the standards for competition are based on metrics geared for fossil fuels, which do not account for the economic and environmental benefits of renewable energy.").

61. Barbara James, *A Modest Proposal for Shaping a Reasonable New World*, ELEC. J., Mar. 1995, at 67, 68 ("The question of which public policy objectives are still valid is *fundamental* and must be answered," as opposed to advancing competition "as an end in itself." (emphasis in original)).

Hand[62] has very little to offer. Much of the commentary proceeds on the assumption that competition is the ultimate value and nothing else matters.[63]

IV. A CHANGE OF DIRECTION: THE CALIFORNIA CASES

A. What the FERC Thought About California's Plan

With these general principles in mind, a close analysis of a recent action of the FERC is instructive. Only lately, the FERC disapproved of California's allocation of PURPA contracts.[64] The California Commission had structured a proposal based on a Biennial Resource Plan Updated (BRPU), the establishment of "benchmark prices" and bidding by the QFs. Of particular interest, the California Commission had reserved approximately half of the capacity solely for renewable bidders. Utilities subject to the California Commission's rule complained, suggesting that California's system would ultimately result in the purchase of unneeded power at inflated prices. Specifically, the utilities in California alleged that the California solicitations to QFs brought in bids from cogeneration facilities at prices below what had been awarded for some renewable capacity; that portions of the solicitations were set aside for renewable bidding; that the bids were segmented into separate capacity blocks; that the bids were distorted by adders or subtractors to reflect environmental externalities; that the final orders ignored updated need projections; that the solicitations were not open to non-QF bidders; and that the orders threatened to create stranded costs in a restructured electric utility industry.

The FERC agreed with the utilities, ultimately finding fault with California's method of determining avoided cost. The FERC first reiterated the basic standard that section 210 of PURPA did not permit either the FERC or the states to set a rate for the purchase of electricity in excess of a utility's avoided cost. The agency then noted that it, and not the states, had the authority to prescribe the rules governing QF rates. Any state process used to calculate avoided costs, in the FERC's view, must square with both the statutes and its regulations.

The FERC then went on to criticize California's process of calculating avoided cost. California had implemented a type of modified bidding process to determine avoided cost. Once the state had administratively determined a benchmark price for a capacity addition, QFs—but only QFs—were allowed to bid against that benchmark price. The FERC believed that this process was infirm because it violated the principle of "all source

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62. *See generally* ADAM SMITH, ON THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (R.L. Meek et al. eds., 1978) (1723).

63. *PURPA Reform Petition*, *supra* note 1, at 4.

64. *See generally Southern Cal. Edison Co., 71 F.E.R.C. ¶ 61,269; 70 F.E.R.C. ¶ 61,215. The FERC's actions were in form grants of petitions for enforcement—essentially simply statements of the FERC's position. The FERC might, if necessary, try to win enforcement of its position in federal court. There seems little doubt that the issue is one of federal—not California—law. See generally* Adam Wenner, *FERC's Connecticut Light & Power Order Overstates PURPA's Preemptive Effect*, ELEC. J., Aug./Sept. 1995, at 52.

bidding."[65] That is, a state, in setting avoided cost, must consider prices from all available energy sources able to sell to the utility whose avoided cost is being determined. Only in this manner, in the agency's view, could it pay heed to PURPA's requirement that rates be "just and reasonable" to ratepayers.

The FERC was also critical of the arguably stale capacity information relied on by the California Commission. In providing a basis for the heightened scrutiny with which it viewed the California methodology, the FERC mentioned its belief that the QF industry had become a developed industry, as well as its view that the transition to competition in the electric industry required more attention to the integration of PURPA with other policies, such as reliance on competition.[66]

The FERC reaffirmed its original order in responding to a motion for reconsideration.[67] The agency again emphasized that no matter what process a state uses to determine avoided cost, a state must consider all sources—"all technologies and all types of sellers"—in setting the price to be paid for QF power. In addition, the FERC reiterated its earlier statement about the impact of its ruling on environmental concerns. The agency stated:

> Our decision today does not, for example, preclude the possibility that, in setting an avoided cost rate, a state may account for environmental costs of all fuel sources included in an all source determination of avoided cost[, but] a state may only account for costs which actually would be incurred by the utility.[68]

The FERC essentially drew a line between internalized environmental costs, which had become pecuniary costs of the utility,[69] and costs to society which had not yet been internalized. The FERC further illustrated this point by indicating that a state might impose a pollution tax on power generated from a particular fuel (such as coal). Such a tax would, of course, become an internalized cost of the utility and as such would be part and parcel of the avoided cost determination. But the FERC said it would be inadmissible to employ adders and subtractors to adjust avoided costs (as the California Commission had done).

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65. The FERC stated: "If the state is determining avoided cost by relying on a combination of benchmark and bidding procedures, as here, this means that the bidding cannot be limited to certain sellers (QFs); rather, it must be all-source bidding." 70 F.E.R.C. ¶ 61,215, at 61,677.

66. *Id.* at 61,675.

67. *See generally* 71 F.E.R.C. ¶ 61,269.

68. *Id.* at 62,080.

69. For a discussion of the nature of internalized costs in the energy industry, see GERALD GARVEY, ENERGY, ECOLOGY, ECONOMY 35-36 (1972). "[I]nternalization changes a pecuniary externality . . . into a pecuniary increment to price." *Id.* at 206-07.

B. The Tension Created by a "Cheapest Power" Approach

This FERC action marked a turning point in the FERC's surveillance of state commissions' implementation of PURPA and of its regulations.[70] Earlier, the FERC had issued several rulings rejecting state approvals of contracts that facially exceeded the full-avoided cost of PURPA power.[71] But the FERC's disapproval of the California proposal marked the first occasion on which the FERC moved aggressively to disapprove a *methodology* of calculating full-avoided cost.

The FERC's line between pecuniary costs and costs to society is a defensible, though not necessarily compelling, distinction if it relies on an interpretation of congressional intent in capping PURPA rates at avoided cost.[72] But this line is not uncontroversial. Commissioner Massey stated that he believed "the majority's order, if strictly construed, may wrongly prevent consideration in the avoided cost determination of a range of non-price factors, factors that are very important but very difficult to assign a dollar value to."[73] This warning is timely because the extent to which states are free to consider non-price factors under PURPA is no longer clear after the FERC's order.

Commissioner Massey pointed out other apparent contradictions in the FERC's approach. In his special concurrence with the original order, he cited various earlier FERC documents apparently endorsing the use of non-price factors in computing full-avoided cost and effecting the award of contracts.[74] In addition, he noted that the congressional commitment to this approach had been reaffirmed in the EPAct.[75] Later, in his partial dissent from the denial of a motion for reconsideration, Commissioner Mas-

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70. As Commissioner Massey mentioned in his partial dissent from the denial of reconsideration, "[u]ntil a few months ago, [the] FERC's approach to state processes under PURPA was hands off. Now, it is hands on." *Southern Cal. Edison Co.*, 71 F.E.R.C. ¶ 61,269, at 62,082.

71. *See, e.g., Connecticut Light & Power Co.*, 70 F.E.R.C. ¶ 61,012 (1995); *Orange and Rockland Utils., Inc., 43 F.E.R.C. ¶ 61,067.*

72. *See* Miles, *supra* note 12, at 1285 (discussing the Senate PURPA hearings and quoting Senator Percy's comment that "[i]t would be wrong to subsidize small [power] producers at the expense of other customers."). *See also* 124 CONG. REC. 38,369 (1978) (statement of Rep. Dingell) ("The underlying philosophy of [PURPA] is that consumers should pay for the cost of the electricity they consume.").

Some commentators seem clear that Congress did not intend that external costs be included in calculations of incremental cost or full-avoided cost. "By not including externalized costs—either in the form of pollution damage or the costs due to overbuilding and inflexibility [of large central station installations]—Congress ensured that society would continue to invest more resources in central station electricity than is efficient or desirable." Bland, *supra* note 13, at 383. In this view, amendment of the statute would be required to incorporate external costs in full-avoided cost.

73. 71 F.E.R.C. ¶ 61,269, at 62,081.

74. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,679.

75. Commissioner Massey stated:

> The consideration of environmental costs and other non-price factors under PURPA is consistent with a recent amendment to PURPA. In the [EPAct], Congress amended PURPA to require states to consider mandating the use of "integrated resource planning." The amendment of PURPA to include this requirement supports construing PURPA's avoided cost standard as allowing consideration of the non-price factors essential to integrated resource planning.

Id. at 61,678.

sey challenged the majority's thinking on non-internalized costs. He wondered how a state might recognize the value of an intangible like fuel diversity if avoided cost determinations were limited to internalized costs. Massey indicated that, "the majority's order moves perilously close to a rule that PURPA requires selection of the cheapest power regardless of the value of fuel diversity."[76] Perhaps the majority would respond by pointing out that Congress recognized fuel diversity by requiring utilities to buy from QFs and provided the latter with other benefits, such as freedom from regulation. In the majority's view, maybe Congress did not also intend that QFs be permitted to sell power at "uncompetitive" prices. But this is only one plausible view. Perhaps, on the other hand, Congress simply did not want to hamstring the FERC and the states in their evaluation of the tangible and intangible costs of power.

Of course, a number of states have employed crude adjustments to reflect the social, in contrast to the pecuniary, cost of electricity. In calculating avoided energy cost, New Jersey has added 10% to the Pennsylvania-New Jersey-Maryland power pool's energy billing rate.[77] The Virginia State Corporation Commission has also taken a strong position in favor of adjusting for "societal and environmental" costs in computing avoided costs.[78] Alaska, Michigan, Idaho, New Hampshire, North Carolina, New York, Oklahoma and Maine, among others, have in varying respects and to varying degrees recognized societal and environmental costs.[79] As Commissioner Massey suggests, these are indeed costs borne by society even if they are not borne by the utility or by the ratepayer.[80] They are costs which may in many cases be avoided by recourse to alternative energy sources.[81]

Perhaps the most interesting and significant argument advanced by the California utilities was the contention that the California QF program was inconsistent with the California Commission's ongoing proposal to restruc-

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76. 71 F.E.R.C. ¶ 61,269, at 62,081. Commissioner Massey also stated "I do concur in [the] fundamental premise [of certain petitions for rulemaking filed with the FERC] that the time has come for a broad-based rulemaking reevaluating PURPA in light of the increased competition in the industry since PURPA was initially enacted . . . ." *Id.* at 62,082.

77. Vanderlinden, *supra* note 20, at 1039.

78. Vanderlinden, *supra* note 20, at 1040.

79. Vanderlinden, *supra* note 20, at 1040-43.

80. Vanderlinden, *supra* note 20, at 1038 (quoting Lucien Smartt, *Estimating the Effect of a PURPA Provision*, PUB. UTILS. FORT., Apr. 14, 1983, at 8) (" 'The societal, or external, costs of central station electric power generation and transmission are [not] paid for by the power industry, and . . . if they were, then a system of small-scale generation projects would appear to be just as economical as, or more so than, the existing system.' ").

How to reflect external costs in electric rates has been a subject with which state regulators have wrestled for many years. *See Madison Gas & Elec.*, 4 Pub. Util. Rep. 4th (PUR) 28, 37-38, 52 (Wis. Pub. Serv. Comm'n 1974) (Cudahy, Comm'r, concurring).

81. Bland, *supra* note 13, at 384 ("[PURPA] should provide that the avoided cost rate determined under present procedures be boosted by a 'kicker,' perhaps in the fifteen to twenty percent range [to include environmental and social costs the utilities externalize]."). *See also* Silverman & Worthman, *supra* note 14, at 12 (estimating that 4 to 8 cents per kilowatt hour should be added to the cost of electricity generated by fossil fuels when comparing the costs associated with them to those of electricity produced from renewable sources).

ture the electric utility industry for direct access by retail customers ("retail wheeling"). The complaining utilities asserted that the failure to consider the possibility of creating costs in contracts with QFs that would subsequently be stranded in a competitive regime violated PURPA and its implementing regulations.[82] The FERC did not rest its decision specifically on this argument, but it did state quite directly that it believed "it is inconsistent with [its] obligation under PURPA to ensure just and reasonable rates, and [its] goals to encourage development of competitive bulk power markets, to permit the use of PURPA to create new contracts that do not reflect market conditions for new bulk power supplies. . . ."[83]

This issue brings into focus the question of PURPA reform as it relates to a competitive restructuring of the electric utility industry. The FERC orders imply that, if we use PURPA to ordain entry into power supply contracts to diversify generation, we may be creating costs that will be left "stranded" in a competitive marketplace, ultimately leaving some entities at an unfair market disadvantage.

Commissioner Massey's response to this problem inquired whether "Congress really intended the avoided cost determination to be driven by the cheapest, minimally acceptable piece of generation on the market, instead of the balancing process inherent in rational planning?"[84] Pursuing this line of inquiry, did Congress in PURPA intend that alternative power sources not be brought on line unless they were as "cheap" as anything else available? Does "cheap" mean cheap to society or cheap to the consumer? Does this standard take into account the numerous factors, both calculable and incalculable, affecting the value of competing power sources? If cheap means competitive, then only commercially-recognized value counts, and all of the intangible values PURPA was presumably intended to serve must yield.

This analysis, however, may put the cart before the horse. Should market competition be the ultimate test—even if it sacrifices societal values such as conservation and the need for fuel diversity? If PURPA values cannot survive competition, does this mean that PURPA must go, or that the market is an inadequate regulator of last resort? The FERC is indeed adjusting its sails to the winds of competitive change—possibly as Congress intended in the EPAct, when it gave teeth to mandatory wheeling. But, as noted, the EPAct seems to contain mixed messages.[85] And the movement toward a competitive regime raises the crucial question, inherent in Commissioner Massey's comments, of whether regulatory values having no pecuniary weight are inconsequential.

Some authors, like Commissioner Massey, have noted the problem of environmental costs, as well as the broader question of fitting value to the

82. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,676.

83. *Id.*

84. *Southern Cal. Edison Co.*, 71 F.E.R.C. ¶ 61,269, at 62,081.

85. In the EPAct, Congress also effected an intervention in the competitive process by providing a 1.5 cent per kilowatt hour production credit for electricity produced from wind. *See* Silverman & Worthman, *supra* note 14, at 16 (citing the EPAct).

avoided cost calculus.[86] These commentators suggest that "[the] FERC seems to believe that a wide range of supply options can be evaluated against a single price. This is wrong. Avoided cost, whether derived administratively, through bidding, or through some combination of the two, does not yield a single number which can be so used."[87] Power supplies, in their view, are not fungible. These authors also note a number of factors that should impact an assessment of "cost."[88] The FERC, however, does not seem to permit assessing the probabilities of even an impending or foreseeable conversion of social costs to pecuniary costs. Even on the apparently critical point of all-source bidding, there is a real question whether it makes sense to require bids from non-QF sources if all the QF bids are substantially below an administratively-determined avoided cost.[89]

None of this is to say that the FERC was legally incorrect in rejecting the results of the California Commission's procedure. The utilities had alleged that lower-cost generation alternatives were readily available for 4 cents per kilowatt-hour or less. They claimed that the California Commission was requiring them to sign contracts with QFs at initial rates as high as 6.6 cents per kilowatt-hour, instead of simply accepting the least costly bids.[90] The utility protests in California reflect utility thinking across the country. Utilities everywhere proclaim that PURPA power is simply too expensive.[91] Perhaps, as noted earlier, the FERC was simply responding to what it believes the congressional direction to be.[92]

The utility position is understandable; because they are focused on an oncoming transition to competition, they are particularly sensitive to regulatory developments that threaten their ability to compete. Before its dramatic intervention in California, the FERC seemed to be walking a fine line in its surveillance of the states' implementation of PURPA. It struck

86. David Moskovitz and Peter Bradford note that 41 states use an integrated resource planning process, often in conjunction with competitive bidding, to make choices about future power supply. *See* David Moskovitz & Peter Bradford, *Paved With Good Intentions: Reflections on FERC's Decisions Reversing State Power Procurement Processes*, ELEC. J., Aug./Sept. 1995, at 62, 63.

87. *Id.* at 62.

88. *Id.* at 64. The article lists twelve factors that influence the worth of power supply—some easier to quantify than others. The point is also made that environmental impacts from, for example, toxins, fine particulates and carbon dioxide may be limited by regulation in the future. The question is then raised as to why the possibility of future pecuniary costs resulting from future regulatory limitation may not be reflected in a present determination of cost.

89. *See id.* at 65.

90. 70 F.E.R.C. ¶ 61,215, at 61,667. However, differences in price may reflect differences in value. *See, e.g.*, Moskovitz & Bradford, *supra* note 86, at 63, 64.

91. *EEI Petition*, *supra* note 1, at 4 ("[The] EEI estimates that QF contracts will cost customers some $38 billion . . . over the next ten years.").

92. The FERC is certainly to be accorded some deference as the interpreter of the statute, *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and its own regulations, *Martin v. Occupational Safety and Health Review Comm'n*, 499 U.S. 144, 150 (1991). The utility allegations suggest substantial discrepancies in consumer cost resulting from the proposed PURPA acquisitions. To the extent that this side of the equation is accorded emphasis, one can hardly reject the FERC's conclusions out of hand—despite questions that knowledgeable observers have raised about its analytical approach. *See, e.g.*, Moskovitz & Bradford, *supra* note 86, at 63.

down state pricing standards which facially exceeded avoided cost.[93] At the same time, however, the FERC refused to allow utilities to unilaterally modify existing contractual arrangements with QFs, despite the fact that, whatever the original situation, the price currently being paid was greater than avoided cost.[94] To some degree, the FERC reflected this long-established position in the California Cases; it made clear that the principles announced there were not to be applied retroactively to undo contractual arrangements already in place.[95]

Thus, the established balance still applied in California where, as noted, the FERC struck down prospective deals it thought too rich but eschewed retroactivity. Still, the FERC's course is clouded by its inattention to value differences in power offerings and its rejection of non-price factors. If this pattern persists, PURPA implementation will be much more narrowly focused than has heretofore been the case.

C. *Repercussions of the Change: National Surveillance*

The California Cases urgently raise the question of the future course of the FERC's PURPA enforcement. Based on the FERC's references to competition and stranded investments, the California Cases could very well lead to an approach under which only internalized costs are dispositive—all other regulatory values, including the environment, diversity of generation, energy self-sufficiency and the like, would have to yield. In addition, the California Cases have serious implications for the balance between state and federal authority, as the FERC has moved aggressively to limit state discretion.

Based on the California factors, it is hard to escape the conclusion that PURPA determinations will, as competition develops, require persistent national surveillance in the interest of uniformity. The National Association of Regulatory Utility Commissioners (NARUC) is, not surprisingly, displeased with this conclusion (and, as a former state regulator, I do not embrace it with enthusiasm), but the California Cases show how the prospect of competition across state lines inspires federal intervention.[96] The same demand for the removal of barriers within the national (or at least regional) market will also raise questions about cost-affecting procedures—like integrated resource planning—now within the exclusive state preserve. If there is to be a national market in electricity, national authority will have to speak to exogenous factors affecting price. And the fixing of avoided costs is certainly a factor that affects the price of electricity. When PURPA was adopted, Congress tended to defer to state authority, the traditional vesting place for regulatory authority over electric utilities. The existence

93. *See Oramge amd Rockland Utils, Inc.*, 43 F.E.R.C. ¶ 61,067. *See also Connecticut Light & Power Co.*, 70 F.E.R.C. ¶ 61,012.

94. *West Penn Power Co.*, 71 F.E.R.C. ¶ 61,153 (1995). *See also New York State Elec. & Gas Corp.*, 71 F.E.R.C. ¶ 61,027 (1995).

95. *Southern Cal. Edison Co.*, 70 F.E.R.C. ¶ 61,215, at 61,678.

96. *See NARUC Resolution*, *supra* note 9, at 2. *See also* Stalon & Lock, *supra* note 54, at 472-73.

of interstate competition, however, will erode this decentralization of authority.

The California Cases make clear that the FERC is already moving to play a more aggressive role in its relationship to the state commissions. This development can hardly be avoided if there is to be a level playing field for competition. The considerations that make interstate commerce in general an exclusive federal province will operate in the electric trade, just as they do elsewhere.

Possibly, this aspect of deregulation and reliance on markets has not been adequately explored by the more dogmatic enthusiasts for a competitive regime. But the California Cases demonstrate that, if there is to be an appropriate balance struck between pure price competition and price competition modified by non-market factors, only a national authority applying nationally-uniform standards can do the job.[97]

So far, at least, the most troubling tendency of the states seems to be toward inflation, rather than diminution, of avoided cost.[98] Hence, the FERC's interventions have been on the side of competitiveness (except, of course, for retroactive competitiveness).[99] Since competitiveness is obviously the very essence of a market regime, the FERC's role can only grow at the expense of that of the states. The utilities are likely not averse to such a trend. But recognition of a heightened role for the FERC is necessarily part and parcel of the new, and not fully understood, world of competition.

D. Broader Implications for the World of Competition

Current competitive developments reveal unanticipated questions about the interplay between regulation and competition.[100] At the outset, one must recognize the efficiency and other benefits associated with competition. And it is generally believed, for instance, that as defects in markets are rectified and market failures repaired, the need for direct

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97. A former FERC official noted that:

> There are probably fifty different methodologies for determining avoided costs. It is like a black box—you stick in a bunch of numbers, and it comes up with a rate, and how it is done is mystical and difficult to understand. There are numbers that are easy to play with, such as the inflation rate selected, and they can profoundly affect the avoided cost rate. Pro-utility state commissions will differ markedly from pro-QF commissions.

Bland, *supra* note 13, at 416 n.215 (quoting from an interview with Glenn J. Berger, former Staff Attorney in the Electric Rates Section and Chairman of the Cogeneration Task Force at the FERC (later with the law firm of Skadden, Arps, Slate, Meagher & Flom), in Washington, D.C. (Feb. 11, 1986)).

98. At least one state, however, has attempted to retroactively alter amounts paid on power supply contracts. Specifically, Rule 58(H) of the Oklahoma Corporation Commission's (OCC) ground rules allows the OCC to approve a contract when it is first proposed, and to then step in and alter it several years later. This rule requires utilities to "include in each contract with a cogeneration or small power producer a clause stating that the OCC may, after notice of hearing, change the terms and otherwise finalize experimental purchase tariffs on special contracts." *Applied Energy Servs. v. Oklahoma Corp. Comm'n*, 31 F.E.R.C. ¶ 61,313, at 61,708 (1985) (Stalon, Comm'r, dissenting).

99. *Id. See also West Penn Power Co.*, 71 F.E.R.C. ¶ 61,027; *New York State Elect. & Gas Corp.*, 71 F.E.R.C. ¶ 61,153.

100. *See* 71 F.E.R.C. ¶ 61,269; 70 F.E.R.C. ¶ 61,215.

regulation disappears.[101] This is particularly true in the case of PURPA. Many observers view PURPA as no more than a regulatory device to lower utility-created barriers to entry of independent generation into the market. Utilities continue to have market power in transmission, although the mandatory wheeling provided in the EPAct[102] has changed this substantially.[103] With respect to generation, utilities continue to dominate, but their position in *new* generation has certainly been reduced. Because more than half the generation added since 1980 has been independently owned, the market power of utilities has correspondingly declined.

In the view of some, apparently, these developments mean that PURPA need not be enforced in a manner as sympathetic to alternative generation as it has been in the past fifteen years. The idea is that, if the barriers to entry have been lowered, alternative generation ought to be able to compete on its own merits; without a regulatory thumb on the scale. There are very cogent reasons, however, to question whether PURPA's goals of diversity in generation, environmental benignity, energy conservation and so forth are going to be recognized and furthered solely by unconstrained market competition.

It may be that the events of the last twenty years have so sapped confidence in government's ability to foresee and anticipate oncoming problems that recourse to the Invisible Hand is regarded as a preferable alternative and as an all-encompassing remedy. These planning and forecasting failures have no doubt heightened the market's appeal as a regulator not afflicted with human frailty. It has become attractive to commit to the workings of an unregulated market issues that in an earlier day might have been the subject of regulatory direction.

Applying these principles to PURPA, one might easily conclude that benefits such as diversity of generation should not be the subject of any purposeful plan, but should be left to the bloodless verdict of the market. To the extent that one is impressed with the serious errors of forecasting and planning, one is tempted to confide everything in the market. Commentators have moved increasingly toward an expansive faith in competition and toward the rejection of policy judgments articulated independently of market forces. This trend, however, unfortunately ignores both the important role of social factors entirely external to the market and the notorious insensitivity of markets to long-term values. Hopefully, both regulators and industry alike will devote some thought to

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101. *See, e.g.*, Bernard S. Black & Richard J. Pierce, Jr., *The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry*, 93 COLUM. L. REV. 1339, 1341-42 (1993).

> We must choose between two revolutionary visions of the future of the electricity sector of the U.S. economy. The first . . . [is] market-based . . . . The second . . . relies on central planners . . . [and] bears an uncomfortable resemblance to the systems previously used to govern the economies of eastern Europe and the former Soviet Union.

Id.

102. *See* 16 U.S.C. § 824k (1994).

103. *Cf.* Cajun Elec. Power Coop. v. FERC, 28 F.3d 173 (D.C. Cir. 1994) (discussing the relationship between market power in generation and market power in transmission service).

these fundamentals before the electric power system finds itself in another crisis.

V. CONCLUSION

The values addressed by PURPA are as important today as they were when the legislation was adopted in 1978. This is true even if plans for competition have moved beyond PURPA. No doubt a large part of the generation added in the last fifteen years meets the PURPA objectives. A plausible—but unconvincing—case can therefore be made for "reforming" PURPA by restricting benefits to alternative energy projects, or even for eliminating the PURPA preference entirely.

This sort of radical surgery, unless PURPA is supplanted by some equally effective regulatory scheme, will likely result in a major downgrading of PURPA's primary objectives. If changes like this are to be made, however, they should be the result of careful deliberation, not an incidental byproduct of sloganeering about competition. The FERC's hard-line approach to avoided cost as employed in the California Cases may, of course, also render the debate moot. In addition, to the extent that electricity moves massively in response to interstate market forces, the FERC will need to keep the playing field level. Attention to this prospect is certainly in order.

However the chips may fall, the essential PURPA objectives—energy conservation and diversification of generating resources—are as worthy today as they were when the statute was enacted. A commitment to competition must be clear-eyed and flexible enough to recognize important goals toward which progress has been made.

Modifications of PURPA may be in order, and reexamination by the FERC and by Congress may be necessary. This ought not, however, involve abandonment of PURPA's basic policy objectives. Retention of PURPA in a form appropriate to serve those goals remains important—even if commitment to market forces is the wave of the immediate future.