

Monday, February 25, 1980

DEPARTMENT OF ENERGY

**Federal Energy Regulatory
Commission**

18 CFR Part 292

(Docket No. RM79-55, Order No. 69)

**Small Power Production and
Cogeneration Facilities; Regulations
Implementing Section 210 of the Public
Utility Regulatory Policies Act of 1978**

AGENCY: Federal Energy Regulatory
Commission.

ACTION: Final rule.

SUMMARY: The Federal Energy
Regulatory Commission hereby adopts
regulations that implement section 210
of the Public Utility Regulatory Policies
Act of 1978 (PURPA). The rules require
electric utilities to purchase electric
power from and sell electric power to
qualifying cogeneration and small power
production facilities, and provide for the
exemption of qualifying facilities from
certain federal and State regulation.
Implementation of these rules is
reserved to State regulatory authorities
and nonregulated electric utilities.

EFFECTIVE DATE: March 20, 1980.

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SUPPLEMENTARY INFORMATION:
Issued February 19, 1980.

Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) requires the Federal Energy Regulatory Commission (Commission) to prescribe rules as the Commission determines necessary to encourage cogeneration and small power production, including rules requiring electric utilities to purchase electric power from and sell electric power to cogeneration and small power production facilities.

Additionally, section 210 of PURPA authorizes the Commission to exempt qualifying facilities from certain Federal and State law and regulation.

Under section 201 of PURPA, cogeneration facilities and small power production facilities which meet certain standards and which are not owned by persons primarily engaged in the generation or sale of electric power can become qualifying facilities, and thus become eligible for the rates and exemptions set forth under section 210 of PURPA.

Cogeneration facilities simultaneously produce two forms of useful energy, such as electric power and steam. Cogeneration facilities use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately. Thus, by using fuels more efficiently, cogeneration facilities can make a significant contribution to the Nation's effort to conserve its energy resources.

Small power production facilities use biomass, waste, or renewable resources, including wind, solar and water, to produce electric power. Reliance on these sources of energy can reduce the need to consume traditional fossil fuels to generate electric power.

Prior to the enactment of PURPA, a cogenerator or small power producer seeking to establish interconnected operation with a utility faced three major obstacles. First, a utility was not generally required to purchase the electric output, at an appropriate rate. Secondly, some utilities charged discriminatorily high rates for back-up service to cogenerators and small power producers. Thirdly, a cogenerator or small power producer which provided electricity to a utility's grid ran the risk of being considered an electric utility and thus being subjected to State and Federal regulation as an electric utility.

Sections 201 and 210 of PURPA are designed to remove these obstacles. Each electric utility is required under

section 210 to offer to purchase available electric energy from cogeneration and small power production facilities which obtain qualifying status under section 201 of PURPA. For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, in the public interest, and which do not discriminate against cogenerators or small power producers. Section 210 also requires electric 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) of PURPA provides that the Commission can exempt qualifying facilities from State regulation regarding utility rates and financial organization, from Federal regulation under the Federal Power Act (other than licensing under Part I), and from the Public Utility Holding Company Act.

I. Procedural History

On June 26, 1979, in Docket No. RM79-54,¹ the Commission issued proposed rules to determine which cogeneration and small power production facilities may become "qualifying" cogeneration or small power production facilities under section 201 PURPA. Such qualifying facilities are entitled to avail themselves of the rate and exemption provisions under section 210 of PURPA; and qualifying cogeneration facilities are eligible for exemption from incremental pricing under Title II of the Natural Gas Policy Act of 1978.² The Commission will soon issue a final rule in Docket No. RM79-54.

As part of the rulemaking process in this docket, the Commission issued a Staff Discussion Paper³ on June 27, 1979, addressing issues arising under section 210 of PURPA.

Public hearings on RM79-54 and the Staff Discussion Paper (RM79-55) were held in San Francisco on July 23, 1979, Chicago on July 27, 1979, and Washington, D.C. on July 30, 1979. Written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking under Section 210 of PURPA in Docket No. RM79-55.⁴ On October 19, 1979, the Commission made available its preliminary Environmental Assessment (EA) of the proposed rules in Docket Nos. RM79-54 and RM79-55. In a

Request for Further Comments,⁵ the Commission requested further public comment on both proposed rules, and on the findings set forth in the preliminary EA. In order to obtain the data, views, and arguments of interested parties, the Commission Staff held public hearings in Seattle on November 19, 1979, in New York on November 28, 1979, in Denver on November 30, 1979, and in Washington, D.C. on December 4 and 5, 1979. The Commission also received written comment.

After consideration of the comments, the Commission Staff made available a final draft rule on January 29, 1980. State public utility commissioners were invited to comment on the draft at a public meeting held on February 5, 1980. Representatives of electric utilities were invited to comment at a public meeting held on February 8, 1980. The Commission Staff also made itself available to any other interested parties who wished to comment. All of the comments were considered in the formulation of this final rule.

In the Staff Discussion Paper and the Request for Further Comments, it was stated that any environmental effects attributable to this program would result from the combined effect of these two rulemaking proceedings. As noted previously, the Commission intends to issue final rules in Docket No. RM79-54 in the near future. At that time, the Commission will also make available its final Environmental Assessment.

II. Summary

These rules provide that electric utilities must purchase electric energy and capacity made available by qualifying cogenerators and small power producers at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy or capacity from other suppliers. To enable potential cogenerators and small power producers to be able to estimate these avoided costs, the rules require electric utilities to furnish data concerning present and future costs of energy and capacity on their systems.

These rules also provide that electric utilities must furnish electric energy to qualifying facilities on a nondiscriminatory basis, and at a rate that is just and reasonable and in the public interest; and that they must provide certain types of service which may be requested by qualifying facilities to supplement or back up those facilities' own generation.

¹ 44 FR 38873, July 3, 1979.

² 44 FR 65744, November 15, 1979.

³ 44 FR 38863, July 3, 1979.

⁴ 44 FR 61190, October 24, 1979.

⁵ 44 FR 61977, October 29, 1979.

The rule exempts all qualifying cogeneration facilities and certain qualifying small power production facilities from certain provisions of the Federal Power Act, from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities, and from State laws regulating electric utility rates and financial organization.

The implementation of these rules is reserved to the State regulatory authorities and nonregulated electric utilities. Within one year of the issuance of the Commission's rules, each State regulatory authority or nonregulated utility must implement these rules. That implementation may be accomplished by the issuance of regulations, on a case-by-case basis, or by any other means reasonably designed to give effect to the Commission's rules.

III. Section-by-Section Analysis

Subpart A—General Provisions

§ 292.101 Definitions.

This section contains definitions applicable to this part of the Commission's rules. Paragraph (a) provides that terms defined in PURPA have the same meaning as they have in PURPA, unless further defined in this part of the Commission's regulations. The definitions in PURPA are found in section 3 of that Act.

Subparagraph (1) defines a qualifying facility as a cogeneration or small power production facility which is a qualifying facility under Subpart B of the Commission's regulations. Those regulations implement section 201 of PURPA, and are the subject of Docket No. RM79-54.

Subparagraph (2) defines "purchase" as the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

Subparagraph (3) defines "sale" as the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

In the proposed rule, subparagraph (4) defined "system emergency" as a condition on a utility's system "which is likely to result in disruption of service to a significant number of customers or is likely to endanger life or property." In response to comments noting the difficulty in determining what constitutes a "significant number" of customers, the Commission has amended the definition to "a condition on an electric utility's system which is likely to result in imminent significant disruption of service to customers, or is imminently likely to endanger life or property." The emphasis is placed on the significance of the disruption of

service, rather than on the number of customers affected.

Subparagraph (5) defines "rate" as any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

In the proposed rule, subparagraph (6) defined "avoided costs" as the costs to an electric utility of energy or capacity or both which, but for the purchase from a qualifying facility, the electric utility would generate or construct itself or purchase from another source. This definition is derived from the concept of "the incremental cost to the electric utility of alternative electric energy" set forth in section 210(d) of PURPA. It includes both the fixed and the running costs on an electric utility system which can be avoided by obtaining energy or capacity from qualifying facilities.

The costs which an electric utility can avoid by making such purchases generally can be classified as "energy" costs or "capacity" costs. Energy costs are the variable costs associated with the production of electric energy (kilowatt-hours). They represent the cost of fuel, and some operating and maintenance expenses. Capacity costs are the costs associated with providing the capability to deliver energy; they consist primarily of the capital costs of facilities.

If, by purchasing electric energy from a qualifying facility, a utility can reduce its energy costs or can avoid purchasing energy from another utility, the rate for a purchase from a qualifying facility is to be based on those energy costs which the utility can thereby avoid. If a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided capacity and energy costs.

The Commission has added the term "incremental" to modify the costs which an electric utility would avoid as a result of making a purchase from a qualifying facility. Under the principles of economic dispatch, utilities generally turn on last and turn off first their generating units with the highest running cost. At any given time, an economically dispatched utility can avoid operating its highest-cost units as a result of making a purchase from a qualifying

facility. The utility's avoided incremental costs (and not average system costs) should be used to calculate avoided costs. With regard to capacity, if a purchase from a qualifying facility permits the utility to avoid the addition of new capacity, then the avoided cost of the new capacity and not the average embedded system cost of capacity should be used.

Many comments noted that the definition of "avoided cost" in the proposed rule failed to link the capacity costs which a utility might avoid as a result of purchasing electric energy or capacity or both from a qualifying facility with the energy costs associated with the new capacity. If the Commission required electric utilities to base their rates for purchases from a qualifying facility on the high capital or capacity cost of a base load unit and, in addition, provided that the rate for the avoided energy should be based on the high energy cost associated with a peaking unit, the electric utilities' purchased power expenses would exceed the incremental cost of alternative electric energy, contrary to the limitation set forth in the last sentence of section 210(b).

One way of determining the avoided cost is to calculate the total (capacity and energy) costs that would be incurred by a utility to meet a specified demand in comparison to the cost that the utility would incur if it purchased energy or capacity or both from a qualifying facility to meet part of its demand, and supplied its remaining needs from its own facilities. The difference between these two figures would represent the utility's net avoided cost. In this case, the avoided costs are the excess of the total capacity and energy cost of the system developed in accordance with the utility's optimal capacity expansion plan,⁶ excluding the qualifying facility, over the total capacity and energy cost of the system (before payment to the qualifying facility) developed in accordance with the utility's optimal capacity expansion plan including the qualifying facility.⁷

Subparagraph (7) defines "interconnection costs" as the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and

⁶ An optimal capacity expansion plan is the schedule for the addition of new generating and transmission facilities which, based on an examination of capital, fuel, operating and maintenance costs, will meet a utility's projected load requirements at the lowest total cost.

⁷ Throughout the rule and preamble, the phrase "energy or capacity" is used. This phrase is intended to include the capacity and energy costs associated with the capacity. If the purchase involves both energy or capacity.

administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection costs do not include any costs included in the calculation of avoided costs.

The Commission has clarified this definition to include distribution and administrative costs associated with the interconnected operation, in response to comments indicating that the proposed rule was vague in these respects. This definition is designed to provide the State regulatory authorities and nonregulated electric utilities with the flexibility to ensure that all costs which are shown to be reasonably incurred by the electric utility as a result of interconnection with the qualifying facility will be considered as part of the obligation of the qualifying facility under § 292.306. These costs may include, but are not limited to, operating and maintenance expenses, the costs of installation of equipment elsewhere on the utility's system necessitated by the interconnection, and reasonable insurance expenses. However, the Commission does not expect that litigation expenses incurred by the utility involving this section will be considered a legitimate interconnection cost to be borne by the qualifying facility.

Certain interconnection costs may be incurred as a result of sales from a utility to a qualifying facility. The Commission notes that the Joint Explanatory Statement of the Committee of Conference (Conference Report) prohibits the use of "unreasonable rate structure impediments, such as unreasonable hook up charges or other discriminatory practices . . ." * This prohibition is reflected in § 292.306(a) of these rules, which provides that interconnection costs must be assessed on a nondiscriminatory basis with respect to other customers with similar load characteristics.

A qualifying facility which is already interconnected with an electric utility for purposes of sales may seek to establish interconnection for the purpose of utility purchases from the

qualifying facility. In this case, the qualifying facility may have compensated the utility for its interconnection costs with respect to sales to the qualifying facility, either as part of the utility's demand or energy charges, or through a separate customer charge. If this is the case, the interconnection costs associated with the purchase include only those additional interconnection expenses incurred by the electric utility as a result of the purchase, and do not include any portion of the interconnection costs for which the qualifying facility has already paid through its retail rates.

One comment recommended that the definition be revised to cover "all identifiable costs, including but not limited to, the costs of interconnection . . . resulting from interconnected operation". The Commission rejects this suggestion in order to maintain consistency with its initial determination to separate the utility's avoided costs with regard to purchases from qualifying facilities, from the costs incurred as a result of interconnection with a qualifying facility. Accordingly, legitimate costs not recovered pursuant to this section can be netted out in the calculation of avoided costs.

This definition also incorporates the concept from the proposed rule, as clarified in an erratum notice,⁹ that these costs are limited to the net increased interconnection costs imposed on an electric utility compared to those interconnection costs it would have incurred had it generated the energy itself or purchased an equivalent amount of energy or capacity from another source.

This section of the rule contains definitions of "supplementary power", "back-up power", "interruptible power", and "maintenance power" which did not appear in the proposed rule.

Subparagraph (8) defines "supplementary power" as electric energy or capacity, supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

Subparagraph (9) defines "back-up power" as electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility.

Subparagraph (10) defines "interruptible power" as electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

Subparagraph (11) defines "maintenance power" as electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

§ 292.301 Scope.

Section 292.301(a) describes the scope of Subpart C of Part 292 of the Commission's rules. Subpart C applies to sales and purchases of electric energy or capacity between qualifying cogeneration or small power production facilities and electric utilities, and actions related to such sales and purchases. Section 292.301(b)(1) provides that this subpart does not preclude negotiated agreements between qualifying cogenerators or small power producers and electric utilities which differ from rates, or terms or conditions which would otherwise be required under the subpart. Paragraph (b)(2) states that this subpart does not affect the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.¹⁰

Paragraph (b)(1) reflects the Commission's view that the rate provisions of section 210 of PURPA apply only if a qualifying cogenerator or small power producer facility chooses to avail itself of that section. Agreements between an electric utility and a qualifying cogenerator or small power producer for purchases at rates different than rates required by these rules, or under terms or conditions different from those set forth in these rules, do not violate the Commission's rules under section 210 of PURPA. The Commission recognizes that the ability of a qualifying cogenerator or small power producer to negotiate with an electric utility is buttressed by the existence of the rights and protections of these rules.

Some comments stated that paragraph (b)(2) would unfairly penalize cogenerators and small power producers who, prior to the promulgation of these regulations, entered into binding contracts with electric utilities under less favorable terms than might be obtainable under these rules. The Commission interprets its mandate under section 210(a) to prescribe "such rules as it determines necessary to encourage cogeneration and small

* Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 96th Cong., 2d Sess. (1978).

⁹ 44 FR 63114, November 2, 1979.

¹⁰ The term "purchase" is defined in § 292.101(b).

power production * * * to mean that the total costs to the utility and the rates to its other customers should not be greater than they would have been had the utility not made the purchase from the qualifying facility or qualifying facilities. That a cogeneration or small power production facility entered into a binding contractual arrangement with an electric utility indicates that it is likely that sufficient incentive existed, and that the further encouragement provided by these rules was not necessary. As a result, the Commission has not revised this provision.

§ 292.302 Availability of electric utility system cost data.

As the Commission observed in the Notice of Proposed Rulemaking, in order to be able to evaluate the financial feasibility of a cogeneration or small power production facility, an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction of a facility. This return will be determined in part by the price at which the qualifying facility can sell its electric output. Under § 292.304 of these rules, the rate at which a utility must purchase that output is based on the utility's avoided costs, taking into account the factors set forth in paragraph (e) of that section. Section 292.302 of these rules is intended by the Commission to assist those needing data from which avoided costs can be derived. It requires electric utilities to make available to cogenerators and small power producers data concerning the present and anticipated future costs of energy and capacity on the utility's system.

In the preamble to the proposed rule, the Commission stated that most electric utilities will have prepared data containing some of this information in compliance with the Commission's rules implementing section 133 of PURPA. Several commenters observed that the marginal cost data required to be provided pursuant to section 133 cannot be directly translated into a rate for purchases. The Commission has clarified paragraph (b) to emphasize that these data are not intended to represent a rate for purchases from qualifying facilities. Rather, these data are to be considered the first step in the determination of such a rate.

The Commission has also revised this section so that the rates for purchases can be more readily calculated from the data produced. The Commission has changed paragraph (b)(3) to provide that a utility shall submit the associated energy cost of each planned unit expressed in kilowatt-hours (kWh)

along with the estimated capacity cost of planned capacity additions. This change is intended to ensure that the calculation of avoided costs includes the lower energy costs that might be associated with the new capacity. The Commission points out that the determination of a rate for purchases from a qualifying facility which enables a utility to defer or avoid the addition of a new unit must also reflect the hours of expected use of the deferred or avoided capacity addition.

The coverage under paragraph (a) of this section is the same as that provided pursuant to section 133 of PURPA and the Commission's rules implementing that section.¹¹ As noted in the Notice of Proposed Rulemaking, section 133 of PURPA applies to each electric utility whose total sales of electric energy for purposes other than resale exceeded 500 million kWh during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

Paragraph (b) provides that each regulated electric utility meeting the requirements of paragraph (a) must furnish to its State regulatory authority, and maintain for public inspection, data related to the costs of energy and capacity on the electric utility's system. Each nonregulated electric utility also must maintain such data for public inspection.

In response to comments received, the Commission has extended the date by which these data must be first provided to November 1, 1980, and changed the second date to May 31, 1982, to conform to the dates required by the Commission's regulations implementing section 133 of PURPA. The Commission has added paragraph (d) to allow a State regulatory authority or nonregulated utility to use a different approach than that provided in paragraph (b). As part of that substitute program, a State regulatory authority or nonregulated electric utility could provide that cost data be updated more frequently than every two years.

Subparagraph (1) of paragraph (b) requires each electric utility to provide the estimated avoided cost of energy on its system for various levels of purchases from qualifying facilities. The levels of purchases are to be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than ten percent of system peak demand for systems less than 1000 megawatts. This information is to be stated on a cents per kilowatt-hour basis, for daily and seasonal peak

and off-peak periods, for the current calendar year and for each of the next five years.

Subparagraph (2) of paragraph (b) requires each electric utility to provide its schedule for the addition of capacity, planned purchases of firm energy and capacity, and planned capacity retirements for each of the next ten years.

Subparagraph (3) of paragraph (b) has been revised, as discussed previously, so that the costs of planned capacity additions include the associated energy costs.

The Commission received comment noting that some States have implemented or are planning to implement alternative methods by which electric utilities' system cost data would be made available. In order to prevent the preparation of duplicative data where the alternative method substantially deviates from the Commission approach, the Commission has added paragraph (d). This paragraph provides that any State regulatory authority or nonregulated electric utility may, after providing public notice in the area served by the utility and after opportunity for public comment, require data different than that which are otherwise required by this section if it determines that avoided costs can be derived from such data. Any State regulatory authority or nonregulated utility shall notify the Commission within 30 days of any determination to substitute data requirements.

If a qualifying facility finds that the alternative requirements do not provide sufficient data from which avoided costs may be derived, the qualifying facility may seek court review of the matter as it can with regard to any other aspect of the State's implementation of this program.

A qualifying facility may wish to sell energy or capacity to an electric utility which is not subject to the reporting requirements of paragraph (b). In that event, paragraph (c) provides that, upon request of a qualifying facility, an electric utility not otherwise covered by paragraph (b) must provide data sufficient to enable the cogenerator or small power producer to estimate the utility's avoided costs. If such utility does not supply the requested data, the qualifying facility may apply to the State regulatory authority which has ratemaking authority over the utility or to this Commission for an order requiring that the information be supplied. The consideration of such applications should take into account the burden imposed on the small utilities.

¹¹ 44 FR 58687, October 11, 1979.

An electric utility which is legally obligated to obtain all of its requirements for electric energy and capacity from another utility may provide the data provided by its supplying utility and the rates at which it currently purchases such energy and capacity for any period during which this obligation will continue. The wholesale rates may require adjustment in order to reflect properly the avoided costs. This is discussed later in this preamble under § 292.303. In the case of small, non-generating utilities, the requirements of this section will be considered to have been satisfied if these cost data are readily available from the supplying utility.

Numerous comments mentioned that the proposed rule did not address the issue of validation of the data to be provided pursuant to this section. As a result, the Commission has added paragraph (e) which provides that any data submitted by an electric utility under this section shall be subject to review by its State regulatory authority. Paragraph (e)(2) places the burden of providing support for the data on the utility supplying the data.

§ 292.303 Electric utility obligations under this subpart.

Section 210(a) of PURPA provides that the Commission prescribe rules requiring electric utilities to offer to purchase electric energy from qualifying facilities. The Commission interprets this provision to impose on electric utilities an obligation to purchase all electric energy and capacity made available from qualifying facilities with which the electric utility is directly or indirectly interconnected, except during periods described in § 292.304(f) or during system emergencies.

A qualifying facility may seek to have a utility purchase more energy or capacity than the utility requires to meet its total system load. In such a case, while the utility is legally obligated to purchase any energy or capacity provided by a qualifying facility, the purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load. These rules impose no requirement on the purchasing utility to deliver unusable energy or capacity to another utility for subsequent sale.

§ 292.303(a) Obligation to purchase from qualifying facilities.

§ 292.303(d) Transmission to other electric utilities. All-Requirement Contracts.

Several commenters noted that the obligation to purchase from qualifying facilities under this section might conflict with contractual commitments

into which they had entered requiring them to purchase all of their requirements from a wholesale supplier. One commenter noted that, with regard to all-requirements rural electric cooperatives, any impairment of the obligation to obtain all of a cooperative's requirements from a generation and transmission cooperative might affect the financing ability of the generation and transmission cooperative. The Commission observes that, in general, if it permitted such contractual provisions to override the obligation to purchase from qualifying facilities, these contractual devices might be used to hinder the development of cogeneration and small power production. The Commission believes that the mandate of PURPA to encourage cogeneration and small power production requires that obligations to purchase under this provision supersede contractual restrictions on a utility's ability to obtain energy or capacity from a qualifying facility.

The Commission has, however, provided an alternate means by which any electric utility can meet this obligation. Under paragraph (d), if the qualifying facility consents, an all-requirements utility which would otherwise be obligated to purchase energy or capacity from the qualifying facility would be permitted to transmit the energy or capacity to its supplying utility. In most instances, this transaction would actually take the form of the displacement of energy or capacity that would have been provided under the all-requirements obligation. In this case, the supplying utility is deemed to have made the purchase and, as a result the all-requirements obligation is not affected.

In addition, if compliance with the purchase obligation would impose a special hardship on an all-requirements customer, the Commission may consider waiving such purchase obligation pursuant to the procedures set forth in § 292.403.

Transmission to Other Facilities

There are several circumstances in which a qualifying facility might desire that the electric utility with which it is interconnected not be the purchaser of the qualifying facility's energy and capacity, but would prefer instead that an electric utility with which the purchasing utility is interconnected make such a purchase. If, for example, the purchasing utility is a non-generating utility, its avoided costs will be the price of bulk purchased power ordinarily based on the average embedded cost of capacity and average energy cost on its

supplying utility's system. As a result, the rate to the qualifying facility would be based on those average costs. If, however, the qualifying facility's output were purchased by the supplying utility, its output ordinarily will replace the highest cost energy on the supplying utility's system at that time, and its capacity might enable the supplying utility to avoid the addition of new capacity. Thus, the avoided costs of the supplying utility may be higher than the avoided cost of the non-generating utility.

This would not appear to be the case if the qualifying facility offers to supply capacity and energy in a situation in which the supplying utility is in an excess capacity situation. Since the supplying utility has excess capacity, its avoided costs would include only energy costs. On the other hand, if the avoided cost were based on the wholesale rate to the all-requirements utility, the avoided cost would include the demand charge included in the wholesale rate, which would usually reflect an allocation of a portion of the fixed charges associated with excess capacity.

Use of the unadjusted wholesale rate fails to take into account the effect of reduced revenue to the supplying utility, as a result of the substitute of the qualifying facility's output for energy previously supplied by the supplying utility. As the level of purchase by the all-requirements utility decreases, the supplying utility's fixed costs will have to be allocated over a smaller number of units of output. In effect, the loss in revenue to the supplying utility will cause the demand charges to the supplying utility's customers (including the all-requirements customers interconnected with the qualifying facility) to increase. Under the definition of "avoided costs" in this section, the purchasing utility must be in the same financial position it would have been had it not purchased the qualifying facility's output. As a result, rather than allocating its loss in revenue among all of its customers, in this situation the supplying utility should assign all of these losses to the all-requirements utility. That utility should, in turn, deduct these losses from its previously calculated avoided costs, and pay the qualifying facility accordingly.

Under these rules, certain small electric utilities are not required to provide system cost data, except upon request of a qualifying facility. If, with the consent of the qualifying facility, a small electric utility chooses to transmit energy from the qualifying facility to a second electric utility, the small utility

can avoid the otherwise applicable requirements that it provide the system cost data for the qualifying facility and that it purchase the energy itself. However, the ability to transmit a purchase to another utility is not limited to these smaller systems; it applies to any utility.

Accordingly, paragraph (d) provides that a utility which receives energy or capacity from a qualifying facility may, with the consent of the qualifying facility, transmit such energy to another electric utility. However, if the first facility does not agree to transmit the purchased energy or capacity, it retains the purchase obligation. In addition, if the qualifying facility does not consent to transmission to another utility, the first utility retains the purchase obligation. Any electric utility to which such energy or capacity is delivered must purchase this energy under the obligations set forth in these rules as if the purchase were made directly from the qualifying facility.

One commenter stated that this provision could result in energy being transmitted to a utility which has little or no information regarding the reliability of the qualifying facility. The Commission believes that, prior to these transactions occurring, it will be in the interest of the qualifying facility to inform any utility to which energy or capacity is delivered, of the nature of those deliveries, so that such energy or capacity can be usefully integrated into that utility's power supply.

Several other commenters believed that this provision went beyond the authority of section 210 of PURPA—namely, that the Commission cannot require the first utility to wheel the power nor the second utility to buy the power. First, the Commission notes that this transmission can only occur with the consent of the utility to which energy or capacity from the qualifying facility is made available. Thus, no utility is forced to wheel. Secondly, section 210 does not limit the obligation to purchase to any particular utility; rather, it is a generally applicable requirement.

Paragraph (d) provides that charges for transmission are not a part of the rate which an electric utility to which energy is transmitted is obligated to pay the qualifying facility. In the case of electric utilities not subject to the jurisdiction of this Commission, these charges should be determined under applicable State law or regulation which may permit agreement between the qualifying facility and any electric utility which transmits energy or capacity with the consent of the qualifying facility. For utilities subject to the Commission's

jurisdiction under Part II of the Federal Power Act, these charges will be determined pursuant to Part II.

The electric utility to which the electric energy is transmitted has the obligation to purchase the energy at a rate which reflects the costs that it can avoid as a result of making such a purchase. In cases in which electricity actually travels across the transmitting utility's system, the amount of energy delivered will be less than that transmitted, due to line losses. When this occurs, the rate for purchase can reflect these losses. In other cases, the energy supplied by the qualifying facility will displace energy that would have been supplied by the purchasing utility to the transmitting utility. In those cases, a unit of energy supplied from the qualifying facility may replace a greater amount of energy from the purchasing utility. In that case, the rate for purchase should be increased to reflect the net gain. These provisions are also set forth in paragraph (d).

§ 292.303(b) Obligation to sell to qualifying facilities.

Paragraph (b) sets forth the statutory requirement of section 210(a) of PURPA that each electric utility offer to sell electric energy to qualifying facilities. The Commission observed in the Notice of Proposed Rulemaking that State law ordinarily sets out the obligation of an electric utility to provide service to customers located within its service area. In most instances, therefore, this rule will not impose additional obligations on electric utilities.

It is possible that a qualifying facility located outside the service area of an electric utility might require back-up, maintenance, or other types of power. The Commission believes that the instructions of section 210(a) of PURPA that it issue rules "as it determines necessary to encourage cogeneration and small power production * * *" mandate that it assure that such facilities are able to fulfill their needs for service.

However, the Commission also recognizes that State and local law limits the authority of some electric utilities to construct lines outside of their service area. Accordingly, the Commission requires electric utilities to serve any qualifying facility, and, subject to the restriction contained therein, to interconnect with any such facility as required in paragraph (c). However, an electric utility is only required to construct lines or other facilities to the extent authorized or required by State or local law. As a result, a qualifying facility outside the service area of a utility may be required

to build its line into the service area of the utility.

§ 292.303(c) Obligation to interconnect.

In the Notice of Proposed Rulemaking, the Commission used the interpretation set forth in the Staff Discussion Paper, that the obligation to interconnect with a qualifying facility is subsumed within the requirement of section 210(a) that electric utilities offer to sell electric energy to and purchase electric energy from qualifying facilities. The Commission observed that to hold otherwise would mean that Congress intended to require that qualifying facilities go through the complex procedures simply to gain interconnection, contrary to the mandate of section 210 of PURPA to encourage cogeneration and small power production.

During the comment period, this question was further explored, and it was suggested that the Commission has ample authority under the general mandate of section 210(a) of PURPA—namely, that it prescribe rules necessary to encourage cogeneration and small power production—to require interconnection.

While these interpretations received substantial support in the comments submitted, they were at the same time criticized on the theory that section 210(e)(3) of PURPA does not provide that a qualifying facility may be exempted from section 210 of the Federal Power Act (added by section 202 of PURPA and providing certain interconnection authority) and that this interconnection section specifically includes qualifying cogenerators and small power producers in its applicability. These commenters contended that since section 210 of the Federal Power Act deals explicitly with the subject of interconnections between qualifying facilities and electric utilities, no other section of that Act can be interpreted as also granting authority on that subject, as such an interpretation would render the express provision "surplusage".

With regard to these criticisms, the Commission observes that this argument might be tenable in the situation in which the section of the legislation which deals explicitly with the subject does not contain an express provision that it is *not* to be considered the exclusive authority on the subject. The Commission notes that section 212 of the Federal Power Act (as added by section 204 of PURPA) sets forth certain determinations that the Commission must make before it can issue an order under either section 210 or 211 of the Federal Power Act.

Section 212(e) states that no provision of section 210 of the Federal Power Act shall be treated "(1) as requiring any person to utilize the authority of such section 210 or 211 in lieu of any other authority of law, or (2) as limiting, impairing, or otherwise affecting any other authority of the Commission under any other provision of law." Thus, the Federal Power Act, as amended, expressly provides that the existence of authority under section 210 of the Federal Power Act to require interconnection is not to be interpreted as excluding any other interconnection authority available under any other law. The Commission emphasizes that the limitation is not restricted to the Federal Power Act, but rather extends to include other authority of law, such as the authority contained in the Public Utility Regulatory Policies Act of 1978, of which section 210 is a part. Clearly, the existence of this provision refutes the contention that section 210 of the Federal Power Act represents the exclusive method by which interconnection can be obtained. As a result, the comment that the direction contained in section 210(e)(3) of PURPA that no qualifying facility can be exempted from section 210 or 212 of the Federal Power Act is not persuasive.

The Commission finds that to require qualifying facilities to go through the complex procedures set forth in section 210 of the Federal Power Act to gain interconnection would, in most circumstances, significantly frustrate the achievement of the benefits of this program. The Commission does not feel that the legal interpretation set forth in the Staff Discussion Paper and the Notice of Proposed Rulemaking is the exclusive theory by which it may require interconnections under this program without resort to sections 210 and 212 of the Federal Power Act. The interpretation brought out during the comment period—that section 210(a) of PURPA provides a general mandate for the Commission to prescribe rules necessary to encourage cogeneration and small power production—provides, in the Commission's view, sufficient authority to require interconnection. The Commission believes that a basic purpose of section 210 of PURPA is to provide a market for the electricity generated by small power producers and cogenerators. The Commission believes that accomplishment of this purpose would be greatly hindered if it were to require qualifying facilities to utilize section 210 of the Federal Power Act as the exclusive means of obtaining interconnection. It therefore concludes

that such a restrictive interpretation of the law is not supportable.

Paragraph (c)(1) thus provides that an electric utility must make any interconnections with a qualifying facility which may be necessary to permit purchases from or sales to the qualifying facility. A State regulatory authority or nonregulated electric utility must enforce this requirement as part of its implementation of the Commission's rules.

In addition, several commenters contended that, if the obligation to interconnect is required under section 210(a) PURPA, the limitation provided in section 212 of the Federal Power Act would not be available. That limitation provides that an electric utility which complies with an interconnection order under section 210 of the Federal Power Act would not be subject to the jurisdiction of the Federal Energy Regulatory Commission for any purposes other than those specified in the interconnection order.

After consideration of this concern, the Commission has added paragraph (c)(2) to provide that no electric utility is required to interconnect with any qualifying facility, if, solely by reason of purchases or sales over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act. This exception is provided because the Commission notes that, in balance, the encouragement of cogeneration and small power production would not be furthered if, by virtue of interconnection with a qualifying facility, a previously nonjurisdictional utility were reluctantly to become subject to federal utility regulation.

§ 292.303(e) Parallel operation.

In the Notice of Proposed Rulemaking, the Commission provided that each electric utility must offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with standards established by the State regulatory authority or nonregulated electric utility with regard to the protection of system reliability pursuant to § 292.308. By operating in parallel, qualifying facilities are enabled to export automatically any electric energy which is not consumed by its own load. The comments submitted have not set forth any convincing reasons for changing the proposed rule. Paragraph (e) thus continues to require each electric utility to offer to operate in parallel with a qualifying facility.

§ 292.304 Rates for purchases.

Section 210(b) of PURPA provides that in requiring any electric utility to purchase electric energy from a qualifying facility, the Commission must ensure that the rates for the purchase be just and reasonable to the electric consumers of the purchasing utility, in the public interest, and nondiscriminatory to qualifying facilities, but that they not exceed the incremental costs of alternative electric energy (the costs of energy to the utility, which, but for the purchase, the utility would generate itself or purchase from another source).

Relation to State Programs

The Commission has become aware that several States have enacted legislation requiring electric utilities in that State to purchase the electrical output of facilities which may be qualifying facilities under the Commission's rules at rates which may differ from the rates required under the Commission's rules implementing section 210 of PURPA.

This Commission has set the rate for purchases at a level which it believes appropriate to encourage cogeneration and small power production, as required by section 210 of PURPA. While the rules prescribed under section 210 of PURPA are subject to the statutory parameters, the States are free, under their own authority, to enact laws or regulations providing for rates which would result in even greater encouragement of these technologies. However, State laws or regulations which would provide rates lower than the federal standards would fail to provide the requisite encouragement of these technologies, and must yield to federal law.

If a State program were to provide that electric utilities must purchase power from certain types of facilities, among which are included "qualifying facilities," at a rate higher than that provided by these rules, a qualifying facility might seek to obtain the benefits of that State program. In such a case, however, the higher rates would be based on State authority to establish such rates, and not on the Commission's rules.

A facility which provides energy or capacity to a utility under State authority may nevertheless seek to obtain exemption from the Federal Power Act, the Public Utility Holding Company Act, and State regulation of electric utilities as available under section 210(e) of PURPA. The Commission notes that the States lack the authority to exempt a facility from

the Federal Power Act or Public Utility Holding Company Act. The Commission finds no inconsistency in a facility's taking advantage of section 210 in order to obtain one of its benefits, while relying on other authority under which to buy from or sell to a utility.

§ 292.304(a) Rates for purchases.

Paragraph (a) sets forth the statutory requirement that rates for purchases be just and reasonable to the electric consumers of the electric utility and in the public interest, and not discriminate against qualifying cogeneration and small power production facilities.

In the proposed rule, the Commission stated that there is a rebuttable presumption that the rate for purchases is acceptable if it reflects the avoided cost resulting from a purchase on the basis of system cost data set forth pursuant to § 292.302 (b) or (c). Many of the comments received stated that this section was ambiguous.¹² The Commission has therefore provided that the rate for purchases meets the statutory requirements if it equals avoided costs, and has eliminated the reference to the "rebuttable presumption".

Some comments recommended that, as a matter of policy, this section be revised to provide that a State regulatory authority or nonregulated utility has discretion to establish the relationship between the avoided cost and the rate for purchases. Other commenters contended that the Commission should specify that the rate for purchase must equal the avoided cost resulting from such a purchase. In addition, several suggested that the Commission adopt a "split-the-savings" approach.

It is possible that developers of technologies which may be included as qualifying facilities may produce and make available power to electric facilities even though their cost of producing this power is greater than the utility's avoided costs. In most instances, however, purchases of energy or capacity from qualifying facilities will only occur when the cost to the qualifying cogenerator or small power producer of producing the energy or capacity is lower than the utility's avoided costs. Only if this is the case will payment by the utility of its avoided costs provide economic benefit for the cogenerator or small power producer.

When one electric utility can provide energy more cheaply than could another electric utility, the two utilities will often

exchange power on a "split-the-savings" basis. In that type of transaction, the two utilities split the difference between the incremental costs incurred and the incremental costs that the purchasing utility would have incurred had it generated the power itself. Several commenters argued that rates for purchases from qualifying facilities should be based upon this same general principle. The effect of such a pricing mechanism would be to transfer to the utility's ratepayers a portion of the savings represented by the cost differential between the qualifying facility and the purchasing electric utility. Several utilities contend that by so allocating these savings, the Commission would provide an incentive for the electric utility to enter into purchase transactions with qualifying cogeneration and small power production facilities.

These commenters also noted that they had previously engaged in purchases from facilities which might become qualifying facilities under the Commission's rules, and they had paid prices for these purchases based on a "split-the-savings" methodology. These commenters observed that if the Commission's rules now require the payment of full avoided cost for these types of purchases, the purchased power expenses of the electric utility would increase.

Moreover, several utilities commented that, for the foreseeable future, they are inextricably tied to the use of oil to produce electricity. They contend that unless they are permitted to purchase energy and capacity from qualifying facilities at a rate somewhere between the qualifying facilities' costs and their own costs, they and their ratepayers will be subject to the continually increasing world price of oil.

Commenters opposing this allocation of savings to parties other than the qualifying facility noted that this section of PURPA is intended to encourage the development of cogeneration and small power production. They noted that in providing for this encouragement, the Commission may not set rates for purchases at a level which exceeds the incremental cost of alternative energy. Therefore, they observed that, under the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they would have paid had the utility not purchased energy and capacity from the qualifying facility.

Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance

of scarce fossil fuels, such as oil and gas, and the more efficient use of energy.

The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

Another concern with the use of a split-the-savings rate for purchases is that it would require a determination of the costs of production of the qualifying facility. A major portion of this legislation is intended to exempt qualifying facilities from the cost-of-service regulation by which electric utilities traditionally have been regulated. The Conference Report noted that:

It is not the intention of the Conferees that cogenerators and small power producers become subject . . . to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.¹³

Thus, section 210(e) of PURPA provides that the Commission shall exempt qualifying facilities from the Public Utility Holding Company Act, from the Federal Power Act and from State law and regulation respecting utility rates or financial organization, to the extent that the Commission determines that such exemption is necessary to encourage cogeneration or small power production.

Several commenters have contended that a determination of the qualifying facility's costs can be made without the detail required by cost-of-service regulation. However, the Commission believes that the basis for the determination of rates for purchases should be the utility's avoided costs and should not vary on the basis of the costs of the particular qualifying facility.

Several commenters recommended that rather than using a split-the-savings approach, the Commission should set rates for purchases at a fixed percentage of avoided costs. The Commission notes that, in most situations, a qualifying cogenerator or small power producer will only produce energy if its marginal cost of production is less than the price he receives for its output. If some fixed percentage is used, a qualifying facility

¹³ Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 97, 95th Cong., 2d. Sess. (1978).

¹² The relationship between the utility system cost data and the rate for purchases is discussed under § 292.302 and § 292.304(b).

may cease to produce additional units of energy when its costs exceed the price to be paid by the utility. If this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs.

§ 292.304(b) Relationship to avoided costs.

"New Capacity"

The proposed rule differentiated between "old" and "new" production in connection with simultaneous purchases and sales. The proposed rule required an electric utility to purchase at its avoided cost the total output of a facility, construction of which was commenced after the date of issuance of these rules, even if the utility simultaneously sells energy to the facility at its retail rate. The effect of this proposed rule was to separate the production aspect of a qualifying facility from its consumption function. Under this approach, the electrical output of a facility is viewed independently of its electrical needs. Thus, if a cogeneration facility produces five megawatts, and consumes three megawatts, it is treated the same as another qualifying facility that produces five megawatts, and that is located next to a factory that uses three megawatts.

The Commission continues to believe that permitting simultaneous purchase and sale is necessary and appropriate to encourage cogeneration and small power production. The limitation contained in the proposed rule was intended to prevent a cogenerator or small power producer, which had found it economical to produce power for its own consumption prior to the issuance of these rules, from receiving the economic rent that might result from the purchase of its entire output at a utility's full avoided cost after that date without new investment on the part of the qualifying facility.

The same reasoning applies to any facility which was in existence prior to the enactment of PURPA, whether or not it seeks to purchase and sell simultaneously. That construction of the facility was commenced prior to that date may indicate that appropriate economic returns were available without the further incentives provided by section 210.

The Commission is aware that in some instances, if a previously existing qualifying facility were not permitted to

receive full avoided costs for its entire output, it would no longer have sufficient incentive to continue to produce electric power. The cost of production may have risen so as to render the previous rate insufficient to cover the costs of production, or permit an appropriate return.

Thus, with regard to facilities, construction of which commenced on or after the date of enactment of PURPA (November 9, 1978), the Commission has determined it appropriate to provide that rates for purchases shall equal full avoided costs. For facilities, construction of which commenced before the enactment of PURPA, the Commission will permit the State regulatory authorities and nonregulated electric utilities to establish rates for purchases at full avoided costs, or at a lower rate, if the State regulatory authority or nonregulated electric utility determines that the lower rate will provide sufficient encouragement of cogeneration and small power production. Thus, if a previously existing facility shows that it requires rates for purchases based on full avoided costs to remain viable, or to increase its output, the State regulatory authority or nonregulated electric utility is required to establish such rates. This distinction is intended to reflect the need for further incentives and the reasonable expectations of persons investing in cogeneration or small power production facilities prior to or subsequent to the enactment of this law.

Paragraph (b)(1) defines "new capacity" as any purchase of capacity from a qualifying facility, construction of which was commenced on or after November 9, 1978. Subparagraph (2) provides that for new capacity, utilities must pay a rate which equals their avoided cost.

A utility must therefore purchase all of the output from a qualifying facility. However, as explained above, for any portion of that output which is not "new capacity," the State regulatory authority or nonregulated electric utility, as provided in paragraph (b)(3), may provide for a lower rate, if it determines that the lower rate will provide sufficient incentive for cogeneration.

Paragraph (b)(4) requires electric utilities to pay full avoided costs for purchases from new capacity made available from a qualifying facility, regardless of whether the electric utility is simultaneously making sales to the qualifying facility.

§ 292.304(c) Standard rates for purchases.

The Notice of Proposed Rulemaking required electric utilities on request of a

qualifying facility to establish a tariff or other method for establishing rates for purchase from qualifying facilities of 10 kw or less. Upon consideration of the comments received, the Commission has determined that the concept of requiring a standard rate for purchases should be retained. Several comments stated that this requirement could similarly be applied to facilities of up to 100 kw or less.

The Commission is aware that the supply characteristics of a particular facility may vary in value from the average rates set forth in the utility's standard rate required by this paragraph. If the Commission were to require individualized rates, however, the transaction costs associated with administration of the program would likely render the program uneconomic for this size of qualifying facility. As a result, the Commission will require that standardized tariffs be implemented for facilities of 100 kw or less.

In addition, some commenters pointed out that standard tariffs can be used on a technology specific basis, to reflect the supply characteristics of the particular technology. Some commenters also observed that the proposed rule did not require that standard rates for purchases from these small facilities be based on the purchasing utility's avoided cost. This omission might have permitted a utility to pay less than that rate for purchases.

The Commission has accordingly revised paragraph (c) to require each State regulatory authority or nonregulated electric utility to cause to be put into effect standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less. The revised rule requires that standard rates for purchases equal the purchasing utility's avoided cost pursuant to paragraphs (a), (b), and (e).

Several commenters noted that standard rates for purchases can also be usefully applied to larger facilities. The Commission believes that the establishment of standard rates for purchases can significantly encourage cogeneration and small power production, provided that these standard rates accurately reflect the costs that the utility can avoid as a result of such purchases. Accordingly, the Commission has added subparagraph (2) which permits, but does not require, State regulatory authorities and nonregulated electric utilities to put into effect a standard rate for purchases from qualifying facilities with a design capacity greater than 100 kilowatts. These rates must equal avoided cost pursuant to paragraphs (a), (b), and (e).

Many commenters at the Commission's public hearings and in written comments recommended that the Commission should require the establishment of "net energy billing" for small qualifying facilities. Under this billing method, the output from a qualifying facility reverses the electric meter used to measure sales from the electric utility to the qualifying facility. The Commission believes that this billing method may be an appropriate way of approximating avoided cost in some circumstances, but does not believe that this is the only practical or appropriate method to establish rates for small qualifying facilities. The Commission observes that net energy billing is likely to be appropriate when the retail rates are marginal cost-based, time-of-day rates. Accordingly, the Commission will leave to the State regulatory authorities and the nonregulated electric utilities the determination as to whether to institute net energy billing.

Paragraph (c)(3)(i) provides that standard rates for purchase should take into account the factors set forth in paragraph (e). These factors relate to the quality of power from the qualifying facility, and its ability to fit into the purchasing utility's generating mix.

Paragraph (e)(vi) is of particular significance for facilities of 100 kW or less. This paragraph provides that rates for purchase shall take into account "the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system . . .". Several commenters presented persuasive evidence showing that an effective amount of capacity may be provided by dispersed small systems, even in the case where delivery of energy from any particular facility is stochastic. Similarly, qualifying facilities may be able to enter into operating agreements with each other by which they are able to increase the assured availability of capacity to the utility by coordinating scheduled maintenance and providing mutual back-up service. To the extent that this aggregate capacity value can be reasonably estimated, it must be reflected in standard rates for purchases.

Several commenters observed that the patterns of availability of particular energy sources can and should be reflected in standard rates. An example of this phenomenon is the availability of wind and photovoltaic energy on a summer peaking system. If it can be shown that system peak occurs when there is bright sun and no wind, rates for purchase could provide a higher capacity payment for photovoltaic cells

than for wind energy conversion systems. For systems peaking on dark windy days, the reverse might be true. Subparagraph (3)(ii) thus provides that standard rates for purchases may differentiate among qualifying facilities on the basis of the supply characteristics of the particular technology.

§ 292.304 (b)(5) and (d) Legally enforceable obligations.

Paragraphs (b)(5) and (d) are intended to reconcile the requirement that the rates for purchases equal the utilities' avoided cost with the need for qualifying facilities to be able to enter into contractual commitments based, by necessity, on estimates of future avoided costs. Some of the comments received regarding this section stated that, if the avoided cost of energy at the time it is supplied is less than the price provided in the contract or obligation, the purchasing utility would be required to pay a rate for purchases that would subsidize the qualifying facility at the expense of the utility's other ratepayers. The Commission recognizes this possibility, but is cognizant that in other cases, the required rate will turn out to be lower than the avoided cost at the time of purchase. The Commission does not believe that the reference in the statute to the incremental cost of alternative energy was intended to require a minute-by-minute evaluation of costs which would be checked against rates established in long term contracts between qualifying facilities and electric utilities.

Many commenters have stressed the need for certainty with regard to return on investment in new technologies. The Commission agrees with these latter arguments, and believes that, in the long run, "overestimations" and "underestimations" of avoided costs will balance out.

Paragraph (b)(5) addresses the situation in which a qualifying facility has entered into a contract with an electric utility, or where the qualifying facility has agreed to obligate itself to deliver at a future date energy and capacity to the electric utility. The import of this section is to ensure that a qualifying facility which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances. This provision can also work to preserve the bargain entered into by the electric utility; should the actual avoided cost be higher than those contracted for, the electric utility is nevertheless entitled to retain the benefit of its contracted for, or otherwise legally enforceable, lower

price for purchases from the qualifying facility. This subparagraph will thus ensure the certainty of rates for purchases from a qualifying facility which enters into a commitment to deliver energy or capacity to a utility.

Paragraph (d)(1) provides that a qualifying facility may provide energy or capacity on an "as available" basis, i.e., without legal obligation. The proposed rule provided that rates for such purchases should be based on "actual" avoided costs. Many comments noted that basing rates for purchases in such cases on the utility's "actual avoided costs" is misleading and could require retroactive ratemaking. In light of these comments, the Commission has revised the rule to provide that the rates for purchases are to be based on the purchasing utility's avoided costs estimated at the time of delivery.¹⁴

Paragraph (d)(2) permits a qualifying facility to enter into a contract or other legally enforceable obligation to provide energy or capacity over a specified term. Use of the term "legally enforceable obligation" is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility.

Many commenters noted the same problems for establishing rates for purchases under subparagraph (2) as in subparagraph (1). The Commission intends that rates for purchases be based, at the option of the qualifying facility, on either the avoided costs at the time of delivery or the avoided costs calculated at the time the obligation is incurred. This change enables a qualifying facility to establish a fixed contract price for its energy and capacity at the outset of its obligation or to receive the avoided costs determined at the time of delivery.

A facility which enters into a long term contract to provide energy or capacity to a utility may wish to receive a greater percentage of the total purchase price during the beginning of the obligation. For example, a level payment schedule from the utility to the qualifying facility may be used to match more closely the schedule of debt service of the facility. So long as the total payment over the duration of the contract term does not exceed the estimated avoided costs, nothing in these rules would prohibit a State regulatory authority or non-regulated electric utility from approving such an arrangement.

¹⁴In addition to the avoided costs of energy, these costs must include the prorated share of the aggregate capacity value of such facilities.

§ 292.304(c) *Factors affecting rates for purchases.*

Capacity Value

An issue basic to this paragraph is the question of recognition of the capacity value of qualifying facilities.

In the proposed rule, the Commission adopted the argument set forth in the Staff Discussion Paper that the proper interpretation of section 210(b) of PURPA requires that the rates for purchases include recognition of the capacity value provided by qualifying cogeneration and small power production facilities. The Commission noted that language used in section 210 of PURPA and the Conference Report as well as in the Federal Power Act supports this proposition.

In the proposed rule, the Commission cited the final paragraph of the Conference Report with regard to section 210 of PURPA:

The conferees expect that the Commission, in judging whether the electric power supplied by the cogenerator or small power producer will replace future power which the utility would otherwise have to generate itself either through existing capacity or additions to capacity or purchase from other sources, will take into account the reliability of the power supplied by the cogenerator or small power producer by reason of any legally enforceable obligation of such cogenerator or small power producer to supply firm power to the utility.¹⁵

In addition to that citation, the Commission notes that the Conference Report states that:

In interpreting the term "incremental costs of alternative energy", the conferees expect that the Commission and the States may look beyond the costs of alternative sources which are instantaneously available to the utility.¹⁶

Several commenters contended that, since section 210(a)(2) of PURPA provides that electric utilities must "purchase electric energy" from qualifying facilities, the rate for such purchases should not include payments for capacity. The Commission observes that the statutory language used in the Federal Power Act uses the term "electric energy" to describe the rates for sales for resale in interstate commerce. Demand or capacity payments are a traditional part of such rates. The term "electric energy" is used throughout the Act to refer both to electric energy and capacity. The Commission does not find any evidence that the term "electric energy" in section 210 of PURPA was intended to refer only to fuel and operating and maintenance

expenses, instead of all of the costs associated with the provision of electric service.

In addition, the Commission notes that to interpret this phrase to include only energy would lead to the conclusion that the rates for sales to qualifying facilities could only include the energy component of the rate since section 210 also refers to "electric energy" with regard to such sales. It is the Commission's belief that this was not the intended result. This provides an additional reason to interpret the phrase "electric energy" to include both energy and capacity.

In implementing this statutory standard, it is helpful to review industry practice respecting sales between utilities. Sales of electric power are ordinarily classified as either firm sales, where the seller provides power at the customer's request, or non-firm power sales, where the seller and not the buyer makes the decision whether or not power is to be available. Rates for firm power purchases include payments for the cost of fuel and operating expenses, and also for the fixed costs associated with the construction of generating units needed to provide power at the purchaser's discretion. The degree of certainty of deliverability required to constitute "firm power" can ordinarily be obtained only if a utility has several generating units and adequate reserve capacity. The capacity payment, or demand charge, will reflect the cost of the utility's generating units.

In contrast, the ability to provide electric power at the selling utility's discretion imposes no requirement that the seller construct or reserve capacity. In order to provide power to customers at the seller's discretion, the selling utility need only charge for the cost of operating its generating units and administration. These costs, called "energy" costs, ordinarily are the ones associated with non-firm sales of power.

Purchases of power from qualifying facilities will fall somewhere on the continuum between these two types of electric service. Thus, for example, wind machines that furnish power only when wind velocity exceeds twelve miles per hour may be so uncertain in availability of output that they would only permit a utility to avoid generating an equivalent amount of energy. In that situation, the utility must continue to provide capacity that is available to meet the needs of its customers. Since there are no avoided capacity costs, rates for such sporadic purchases should thus be based on the utility system's avoided incremental cost of energy. On the other hand, testimony at the Commission's public hearings indicated that effective

amounts of firm capacity exist for dispersed wind systems, even though each machine, considered separately, could not provide capacity value. The aggregate capacity value of such facilities must be considered in the calculation of rates for purchases, and the payment distributed to the class providing the capacity.

Some technologies, such as photovoltaic cells, although subject to some uncertainty in power output, have the general advantage of providing their maximum power coincident with the system peak when used on a summer peaking system. The value of such power is greater to the utility than power delivered during off-peak periods. Since the need for capacity is based, in part, on system peaks, the qualifying facility's coincidence with the system peak should be reflected in the allowance of some capacity value and an energy component that reflects the avoided energy costs at the time of the peak.

A facility burning municipal waste or biomass may be able to operate more predictably and reliably than solar or wind systems. It can schedule its outages during times when demand on the utility's system is low. If such a unit demonstrates a degree of reliability that would permit the utility to defer or avoid construction of a generating unit or the purchase of firm power from another utility, then the rate for such a purchase should be based on the avoidance of both energy and capacity costs.

In order to defer or cancel the construction of new generating units, a utility must obtain a commitment from a qualifying facility that provides contractual or other legally enforceable assurances that capacity from alternative sources will be available sufficiently ahead of the date on which the utility would otherwise have to commit itself to the construction or purchase of new capacity. If a qualifying facility provides such assurances, it is entitled to receive rates based on the capacity costs that the utility can avoid as a result of its obtaining capacity from the qualifying facility.

Other comments with regard to the requirement to include capacity payments in avoided costs generally track those set forth in the Staff Discussion Paper and the proposed rule. The thrust of these comments is that, in order to receive credit for capacity and to comply with the requirement that rates for purchases not exceed the incremental cost of alternative energy, capacity payments can only be required when the availability of capacity from a qualifying facility or facilities actually permits the purchasing utility to reduce

¹⁵ Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 99th Cong., 2d Sess. (1978).

¹⁶ *Id.*, pp. 98-9.

its need to provide capacity by deferring the construction of new plant or commitments to firm power purchase contracts. In the proposed rule, the Commission stated that if a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating plant, to enable it to build a smaller, less expensive plant, or to purchase less firm power from another utility than it would otherwise have purchased, then the rates for purchases from the qualifying facility must include the avoided capacity and energy costs. As indicated by the preceding discussion, the Commission continues to believe that these principles are valid and appropriate, and that they properly fulfill the mandate of the statute.

The Commission also continues to believe, as stated in the proposed rule, that this rulemaking represents an effort to evolve concepts in a newly developing area within certain statutory constraints. The Commission recognizes that the translation of the principle of avoided capacity costs from theory into practice is an extremely difficult exercise, and is one which, by definition, is based on estimation and forecasting of future occurrences. Accordingly, the Commission supports the recommendation made in the Staff Discussion Paper that it should leave to the States and nonregulated utilities "flexibility for experimentation and accommodation of special circumstances" with regard to implementation of rates for purchases. Therefore, to the extent that a method of calculating the value of capacity from qualifying facilities reasonably accounts for the utility's avoided costs, and does not fail to provide the required encouragement of cogeneration and small power production, it will be considered as satisfactorily implementing the Commission's rules.

§ 292.304(e) Factors affecting rates for purchases.

As noted previously, several commenters observed that the utility system cost data required under § 292.302 cannot be directly applied to rates for purchase. The Commission acknowledges this point and, as discussed previously, has provided that these data are to be used as a starting point for the calculation of an appropriate rate for purchases equal to the utility's avoided cost. Accordingly, the Commission has removed the reference to the utility system cost data from the definition of rates for purchases, and has inserted the

reference to these data in paragraph (e), as one factor to be considered in calculating rates for purchases. Subparagraph (1) states that these data shall, to the extent practicable, be taken into account in the calculation of a rate for purchases.

Subparagraph (2) deals with the availability of capacity from a qualifying facility during system daily and seasonal peak periods. If a qualifying facility can provide energy to a utility during peak periods when the electric utility is running its most expensive generating units, this energy has a higher value to the utility than energy supplied during off-peak periods, during which only units with lower running costs are operating.

The preamble to the proposed rule provided that, to the extent that metering equipment is available, the State regulatory authority or nonregulated electric utility should take into account the time or season in which the purchase from the qualifying facility occurs. Several commenters interpreted this statement as implying that, by refusing to install metering equipment, an electric utility could avoid the obligation to consider the time at which purchases occur. This is not the intent of this provision. Clearly, the more precisely the time of purchase is recorded the more exact the calculation of the avoided costs, and thus the rate for purchases, can be. Rather than specifying that exact time-of-day or seasonal rates for purchases are required, however, the Commission believes that the selection of a methodology is best left to the State regulatory authorities and nonregulated electric utilities charged with the implementation of these provisions.

Clauses (i) through (v) concern various aspects of the reliability of a qualifying facility. When an electric utility provides power from its own generating units or from those of another electric utility, it normally controls the production of such power from a central location. The ability to so control power production enhances a utility's ability to respond to changes in demand, and thereby enhances the value of that power to the utility. A qualifying facility may be able to enter into an arrangement with the utility which gives the utility the advantage of dispatching the facility. By so doing, it increases its value to the utility. Conversely, if a utility cannot dispatch a qualifying facility, that facility may be of less value to the utility.

Clause (ii) refers to the expected or demonstrated reliability of a qualifying facility. A utility cannot avoid the construction or purchase of capacity if it

is likely that the qualifying facility which would claim to replace such capacity may go out of service during the period when the utility needs its power to meet system demand. Based on the estimated or demonstrated reliability of a qualifying facility, the rate for purchases from a qualifying facility should be adjusted to reflect its value to the utility.

Clause (iii) refers to the length of time during which the qualifying facility has contractually or otherwise guaranteed that it will supply energy or capacity to the electric utility. A utility-owned generating unit normally will supply power for the life of the plant, or until it is replaced by more efficient capacity. In contrast, a cogeneration or small power production unit might cease to produce power as a result of changes in the industry or in the industrial processes utilized. Accordingly, the value of the service from the qualifying facility to the electric utility may be affected by the degree to which the qualifying facility ensures by contract or other legally enforceable obligation that it will continue to provide power. Included in this determination, among other factors, are the term of the commitment, the requirement for notice prior to termination of the commitment, and any penalty provisions for breach of the obligation.

In order to provide capacity value to an electric utility a qualifying facility need not necessarily agree to provide power for the life of the plant. A utility's generation expansion plans often include purchases of firm power from other utilities in years immediately preceding the addition of a major generation unit. If a qualifying facility contracts to deliver power, for example, for a one year period, it may enable the purchasing utility to avoid entering into a bulk power purchase arrangement with another utility. The rate for such a purchase should thus be based on the price at which such power is purchased, or can be expected to be purchased, based upon bona fide offers from another utility.

Clause (iv) addresses periods during which a qualifying facility is unable to provide power. Electric utilities schedule maintenance outages for their own generating units during periods when demand is low. If a qualifying facility can similarly schedule its maintenance outages during periods of low demand, or during periods in which a utility's own capacity will be adequate to handle existing demand, it will enable the utility to avoid the expenses associated with providing an equivalent amount of

capacity. These savings should be reflected in the rate for purchases

Clause (v) refers to a qualifying facility's ability and willingness to provide capacity and energy during system emergencies. Section 292.307 of these regulations concerns the provision of electric service during system emergencies. It provides that, to the extent that a qualifying facility is willing to forego its own use of energy during system emergencies and provide power to a utility's system, the rate for purchases from the qualifying facility should reflect the value of that service. Small power production and cogeneration facilities could provide significant back-up capability to electric systems during emergencies. One benefit of the encouragement of interconnected cogeneration and small power production may be to increase overall system reliability during such emergency conditions. Any such benefit should be reflected in the rate for purchases from such qualifying facilities.

Another related factor which affects the capacity value of a qualifying facility is its ability to separate its load from its generation during system emergencies. During such emergencies an electric utility may institute load shedding procedures which may, among other things, require that industrial customers or other large loads stop receiving power. As a result, to provide optimal benefit to a utility in an emergency situation, a qualifying facility might be required to continue operation as a generating plant, while simultaneously ceasing operation as a load on the utility's system. To the extent that a facility is unable to separate its load from its generation, its value to the purchasing utility decreases during system emergencies. To reflect such a possibility, clause (v) provides that the purchasing utility may consider the qualifying facility's ability to separate its load from its generation during system emergencies in determining the value of the qualifying facility to the electric utility.

Clause (vi) refers to the aggregate capability of capacity from qualifying facilities to displace planned utility capacity. In some instances, the small amounts of capacity provided from qualifying facilities taken individually might not enable a purchasing utility to defer or avoid scheduled capacity additions. The aggregate capability of such purchases may, however, be sufficient to permit the deferral or avoidance of a capacity addition. Moreover, while an individual qualifying facility may not provide the equivalent

of firm power to the electric utility, the diversity of these facilities may collectively comprise the equivalent of capacity.

Clause (vii) refers to the fact that the lead time associated with the addition of capacity from qualifying facilities may be less than the lead time that would have been required if the purchasing utility had constructed its own generating unit. Such reduced lead time might produce savings in the utility's total power production costs, by permitting utilities to avoid the "lumpiness," and temporary excess capacity associated therewith, which normally occur when utilities bring on line large generating units. In addition, reduced lead time provides the utility with greater flexibility with which it can accommodate changes in forecasts of peak demand.

Subparagraph (3) concerns the relationship of energy or capacity from a qualifying facility to the purchasing electric utility's need for such energy or capacity. If an electric utility has sufficient capacity to meet its demand, and is not planning to add any new capacity to its system, then the availability of capacity from qualifying facilities will not immediately enable the utility to avoid any capacity costs. However, an electric utility system with excess capacity may nevertheless plan to add new, more efficient capacity to its system. If purchases from qualifying facilities enable a utility to defer or avoid these new planned capacity additions, the rate for such purchases should reflect the avoided costs of these additions. However, as noted by several commenters, the deferral or avoidance of such a unit will also prevent the substitution of the lower energy costs that would have accompanied the new capacity. As a result, the price for the purchase of energy and capacity should reflect these lower avoided energy costs that the utility would have incurred had the new capacity been added.

This is not to say that electric utilities which have excess capacity need not make purchases from qualifying facilities; qualifying facilities may obtain payment based on the avoided energy costs on a purchasing utility's system. Many utility systems with excess capacity have intermediate or peaking units which use high-cost fossil fuel. As a result, during peak hours, the energy costs on the systems are high, and thus the rate to a qualifying utility from which the electric utility purchases energy should similarly be high.

Subparagraph (4) addresses the costs or savings resulting from line losses. An appropriate rate for purchases from a qualifying facility should reflect the cost

savings actually accruing to the electric utility. If energy produced from a qualifying facility undergoes line losses such that the delivered power is not equivalent to the power that would have been delivered from the source of power it replaces, then the qualifying facility should not be reimbursed for the difference in losses. If the load served by the qualifying facility is closer to the qualifying facility than it is to the utility, it is possible that there may be net savings resulting from reduced line losses. In such cases, the rates should be adjusted upwards.

§ 292.303(f) Periods during which purchase are not required.

The proposed rule provided that an electric utility will not be required to purchase energy and capacity from qualifying facilities during periods in which such purchases will result in net increased operating costs to the electric utility. This section was intended to deal with a certain condition which can occur during light loading periods. If a utility operating only base load units during these periods were forced to cut back output from the units in order to accommodate purchases from qualifying facilities, these base load units might not be able to increase their output level rapidly when the system demand later increased. As a result, the utility would be required to utilize less efficient, higher cost units with faster start-up to meet the demand that would have been supplied by the less expensive base load unit had it been permitted to operate at a constant output.

The result of such a transaction would be that rather than avoiding costs as a result of the purchase from a qualifying facility, the purchasing electric utility would incur greater costs than it would have had it not purchased energy or capacity from the qualifying facility. A strict application of the avoided cost principle set forth in this section would assess these additional costs as negative avoided costs which must be reimbursed by the qualifying facility. In order to avoid the anomalous result of forcing a qualifying utility to pay an electric utility for purchasing its output, the Commission proposed that an electric utility be required to identify periods during which this situation would occur, so that the qualifying facility could cease delivery of electricity during those periods.

Many of the comments received reflected a suspicion that electric utilities would abuse this paragraph to circumvent their obligation to purchase from qualifying facilities. In order to minimize that possibility, the Commission has revised this paragraph

to provide that any electric utility which seeks to cease purchasing from qualifying facilities must notify each affected qualifying facility prior to the occurrence of such a period, in time for the qualifying facility to cease delivery of energy or capacity to the electric utility. This notification can be accomplished in any reasonable manner determined by the State regulatory authority. Any claim by an electric utility that such a light loading period will occur or has occurred is subject to such verification by its State regulatory authority as the State authority determines necessary or appropriate either before or after its occurrence. Moreover, any electric utility which fails to provide adequate notice or which incorrectly identifies such a period will be required to reimburse the qualifying facility for energy or capacity supplied as if such a light loading period had not occurred.

The section has also been modified to clarify that such periods must be due to operational circumstances.

The Commission does not intend that this paragraph override contractual or other legally enforceable obligations incurred by the electric utility to purchase from a qualifying facility. In such arrangements, the established rate is based on the recognition that the value of the purchase will vary with the changes in the utility's operating costs. These variations ordinarily are taken into account, and the resulting rate represents the average value of the purchase over the duration of the obligation. The occurrence of such periods may similarly be taken into account in determining rates for purchases.

Tax Issues

The Conference Report states that:

* * * the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or the small power producer's power should not be burdened by the same examination as are utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.¹⁷

The Commission notes that section 301(b)(2) of the Energy Tax Act of 1978¹⁸ makes certain energy property eligible for increased business investment tax credit. Some of this property is commonly used in cogeneration and small power production. However, section 301(b)(2)(B) excludes from such eligibility property "which is public

utility property (within the meaning of section 46(f)(5) of the Internal Revenue Code of 1954)." ¹⁹ As a result, if the property of a qualifying facility which was otherwise eligible for the credit were to be classified as public utility property under section 46(f)(5) of the Internal Revenue Code, it would not be eligible for the increased investment tax credit.

The Commission notes that the Treasury Department's regulations provide that the definition of "public utility property" does not include property used in the business of the furnishing or sale of electric energy if the rates are not subject to regulation that fixes a rate of return on investment.²⁰ On this basis, the Commission believes that property of a qualifying facility that would otherwise be eligible for the energy tax credit would not be excluded from that eligibility under the public utility property exclusion.

First, this Commission is exempting property of qualifying facilities from regulation under Part II of the Federal Power Act, and from similar State and local laws and regulatory programs. Secondly, the Commission observes that the rates a qualifying facility will receive for sales of power to utilities are *not* based on a regulatory scheme which fixes a rate of return on investment of the qualifying facility.

As a result, the Commission believes that energy property of qualifying facilities should not be barred from eligibility for the tax credit by reason of the public utility property exclusion. The Commission wishes to express its opinion on this matter in an effort to further encourage cogeneration and small power production by means of this rulemaking process.

§ 292.305 Rates for sales.

Section 210(c) of PURPA provides that the rules requiring utilities to sell electric energy to qualifying facilities shall ensure that the rates for such sales are just and reasonable, in the public interest, and nondiscriminatory with respect to qualifying cogenerators or small power producers. This section contemplates formulation of rates on the basis of traditional ratemaking (*i.e.*, cost-of-service) concepts.

Paragraph (a) expresses the statutory requirement that such rates be just and reasonable and in the public interest. Paragraph (a) also provides that rates for sales from electric utilities to qualifying facilities not be

discriminatory against such facilities in comparison to rates to other customers served by the electric utility.

A qualifying facility is entitled to purchase back-up or standby power at a nondiscriminatory rate which reflects the probability that the qualifying facility will or will not contribute to the need for and the use of utility capacity. Thus, where the utility must reserve capacity to provide service to a qualifying facility, the costs associated with that reservation are properly recoverable from the qualifying facility, if the utility would similarly assess these costs to non-generating customers.

In the proposed rule, paragraph (b) required electric utilities to provide energy and capacity and other services to any qualifying facility at a rate at least as favorable as would be provided to a customer who does not have his own generation. The comments received concerning this paragraph noted that this provision might be interpreted as requiring an electric utility to provide service to a qualifying facility at its most favorable rate, even if the qualifying facility would not be eligible for such a rate if it did not have its own generation. It is not the Commission's intention that, for example, an industrial cogenerator receive service at a rate applicable to residential customers; rather, such a customer should be charged at a rate applicable to a non-generating industrial customer unless the electric utility shows that a different rate is justified on the basis of sufficient load or other cost-related data. Accordingly, this section now provides that for qualifying facilities which do not simultaneously sell and purchase from the electric utility, the rate for sales shall be the rate that would be charged to the class to which the qualifying facility would be assigned if it did not have its own generation.

Subparagraph (2) provides that if, on the basis of accurate data and consistent system-wide costing principles, the utility demonstrates that the rate that would be charged to a comparable customer without its own generation is not appropriate, the utility may base its rates for sales upon those data and principles. The utility may only charge such rates on a nondiscriminatory basis, however, so that a cogenerator will not be singled out to lose any interclass or intraclass subsidies to which it might have been entitled had it not generated part of its electric energy needs itself.

In situations where a qualifying facility simultaneously sells its output to an electric utility and purchases its requirements from that electric utility, as a bookkeeping matter, the facility's

¹⁷ Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 98, 95th Cong., 2d Sess. (1978).

¹⁸ Pub. L. No. 95-618, 26 U.S.C. §§ 46, 48, November 9, 1978.

¹⁹ 26 U.S.C. § 46(e)(3)(b).

²⁰ Treasury Reg. § 146-3(g)(2), T.D. 7602 (March 23, 1979).

electrical output will not serve its own load, but rather will be supplied to the grid. As a result, the facility's electric load is likely to have the same characteristics as the load of other non-generating customers of the utility. If the utility does not provide data showing otherwise, the appropriate rate for sales to such a facility is the rate that would be charged to a comparable customer without its own generation.

Paragraph (b)(2) of the rule sets forth certain types of service which electric utilities are required to provide qualifying facilities upon request of the facility. These types of service are supplementary power, back-up power, interruptible power and maintenance power. In response to comments, these terms are defined in the text of the rules, as well as in this preamble.

Back-up or maintenance service provided by an electric utility replaces energy or capacity which a qualifying facility ordinarily supplies to itself. These rules authorize certain facilities to purchase and sell simultaneously. The amount of energy or capacity provided by an electric utility to meet the load of a facility which simultaneously purchases and sells will vary only in accordance with changes in the facility's load; interruptions in the facility's generation will be manifested as variations in purchases from the facility. In such a case, sales to the qualifying facility will not be back-up or maintenance service, but will be similar to the full-requirements service that would be provided if the facility were a non-generating customer.

Supplementary power is electric energy or capacity used by a facility in addition to that which it ordinarily generates on its own. Thus, a cogeneration facility with a capacity of ten megawatts might require five more megawatts from a utility on a continuing basis to meet its electric load of fifteen megawatts. The five megawatts supplied by the electric utility would normally be provided as supplementary power.

Back-up power is electric energy or capacity available to replace energy generated by a facility's own generation equipment during an unscheduled outage. In the example provided above, a cogeneration facility might contract with an electric utility for the utility to have available ten megawatts, should the cogeneration's units experience an outage.

Maintenance power is electric energy or capacity supplied during scheduled outages of the qualifying facility. By pre-arrangement, a utility can agree to provide such energy during periods when the utility's other load is low, thereby avoiding the imposition of large

demands on the utility during peak periods.

Interruptible power is electric energy or capacity supplied to a qualifying facility subject to interruption by the electric utility under specified conditions. Many utilities have utilized interruptible service to avoid expensive investment in new capacity that would otherwise be necessary to assure adequate reserves at time of peak demand. Under this approach utilities assure the adequacy of reserves by arranging to reduce peak demand, rather than by adding capacity. Interruptible service is therefore normally provided at a lower rate than non-interruptible service.

During the Commission's public hearings on this rulemaking, one commenter stated that utilities which have excess capacity do not save any costs by providing interruptible service. The commenter contended that the Commission should not require a utility with excess capacity to offer interruptible service. If a utility is not adding capacity (whether by construction or purchase) to meet anticipated increases in peak demand, the rates charged for interruptible service might appropriately be the same as for non-interruptible services.

The Commission believes that these matters involving the provision of interruptible rates are best handled through the pricing mechanism. However, if as discussed above, interruptible customers provide no savings to the electric utility, the rate for interruptible service need not be lower than the rate for firm service. In such a case, the Commission would consider granting a waiver from this paragraph, under the provisions of § 292.403.

Some comments noted that certain electric utilities do not have any generating capacity, and to require the services listed in subparagraph (1) might place an undue burden on the electric utility. In light of these comments, the State regulatory authorities or the Commission, as the case may be, will allow a waiver of these requirements upon a finding after a showing by the utility to the State regulatory authority or Commission, as the case may be, that provision of these services will impair the utility's ability to render adequate service to its customers or place an undue burden on the electric utility. Notice must be given in the area served by the electric utility, opportunity for public comment must be provided, and an application must be submitted to the State regulatory authority with respect to any electric utility over which it has ratemaking authority or the Commission

with respect to any nonregulated electric utility.

Paragraph (c)(1) provides that rates for sales of back-up or maintenance power shall not be based, without factual data, on the assumption that forced outages or other reductions in output by each qualifying facility on an electric utility's system will occur either simultaneously or during the system peak. Like other customers, qualifying facilities may well have intraclass diversity. In addition, because of the variations in size and load requirements among various types of qualifying facilities, such facilities may well have interclass diversity.

The effect of such diversity is that an electric utility supplying back-up or maintenance power to qualifying facilities will not have to plan for reserve capacity to serve such facilities on the assumption that every facility will use power at the same moment. The Commission believes that probabilistic analyses of the demand of qualifying facilities will show that a utility will probably not need to reserve capacity on a one-to-one basis to meet back-up requirements. Paragraph (c)(1) prohibits utilities from basing rates on the assumption that qualifying facilities will impose demands simultaneously and at system peak unless supported by factual data.

The rule provides that utilities may refute these assumptions on the basis of factual data. These data need not be in the form of empirical load data. It might be the case that within certain geographic areas, weather data and performance data would constitute a sufficient basis to refute the assumption relating to the coincidence of the demands imposed, for example, by windmills or photovoltaics, with respect to their need for back-up power.

Paragraph (c)(2) provides that rates for sales shall take into account the extent to which a qualifying facility can usefully coordinate periods of scheduled maintenance with an electric utility. If a qualifying facility stays on line when the utility will need its capacity, and schedules maintenance when the utility's other units are operative, the qualifying facility is more valuable to the utility, as it can reduce its capacity requirements.

§ 292.306 Interconnection costs.

Paragraph (a) states that each qualifying facility must reimburse any electric utility which purchases capacity or energy from the qualifying facility for any interconnection costs, on a nondiscriminatory basis with respect to other customers with similar load characteristics. The Commission finds

merit in those comments which suggested that the basis of comparison for nondiscriminatory practices in the proposed rule to "any other customer" was too broad, and that the correct reference for nondiscrimination is the practice of the utility in relation to customers in the same class who do not generate electricity. As noted previously, the interconnection costs of a facility which is already interconnected with the utility for purposes of sales are limited to any additional expenses incurred by the utility to permit purchases.

Several commenters expressed their concern that some protection should be provided to qualifying facilities from potential harassment by utilities in the form of requiring unnecessary safety equipment. As discussed above, the State regulatory authorities (with respect to electric utilities over which they have ratemaking authority) and nonregulated electric utilities have the responsibility and authority to ensure that the interconnection requirements are reasonable, and that associated costs are legitimately incurred.

For qualifying facilities with a design capacity of 100 kW or less, the Commission noted that interconnection costs could be assessed on a class basis, and the standard rates for purchases established for classes of facilities of this size pursuant to § 292.304(c)(1) might incorporate these costs. State regulatory authorities (with respect to electric utilities over which they have ratemaking authority) or nonregulated electric utilities may also determine interconnection costs for qualifying facilities with a design capacity of more than 100 kW on either a class average or individual basis.

Numerous comments raised the point that the proposed rule did not address the manner in which electric utilities would be reimbursed. Potential owners and developers of qualifying facilities recommended that the costs be amortized on a reasonable basis, because paying a large lump sum payment would be a considerable obstacle to the program. Electric utilities generally preferred payment up front, although several commenters indicated that amortization might be acceptable for credit-worthy facilities. The Commission believes that the manner of reimbursements (which may include amortization over a reasonable period of time) is best left to the State regulatory authorities and nonregulated utilities. In the determination of any standard rates for purchases established pursuant to § 292.304(c)(i), if the State approves some manner of amortization, it might

consider assignment of uncollected interconnection costs to the class for which the rate is established.

§ 292.307 System emergencies.

Paragraph (a) provides that, except as provided under section 202(c) of the Federal Power Act, no qualifying facility shall be compelled to provide energy or capacity to the electric utility during an emergency beyond the extent provided by agreement between the qualifying facility and the utility.

The Commission finds that a qualifying facility should not be required to make available all of its generation to the utility during a system emergency. Such a requirement might interrupt industrial processes with resulting damage to equipment and manufactured goods. Many industries install their own generating equipment in order to ensure that even during a system emergency, their supply of power is not interrupted. To put in jeopardy the availability of power to a qualifying facility during a system emergency because of the facility's ability to provide power to the system during non-emergency periods would result in the discouragement of interconnected operation and a resultant discouragement of cogeneration and small power production. The Commission therefore provides that the qualifying facility's obligation to provide energy and capacity in emergencies be established through contract.

In order to receive full credit for capacity, a qualifying facility must offer energy and capacity during system emergencies to the same extent that it has agreed to provide energy and capacity during non-emergency situations. For example, a 30 megawatt cogenerator may require 20 megawatts for its own industrial purposes, and thus may contract to provide 10 megawatts of capacity to the purchasing utility. During an emergency, the cogenerator must provide the 10 megawatts contracted for to the utility; it need not disrupt its industrial processes by supplying its full capability of 30 megawatts. Of course, if it should so desire, a cogenerator could contractually agree to supply the full 30 megawatts during system emergencies. The availability of such additional backup capacity should increase utility system reliability, and should be accounted for in the utility's rates for purchases from the cogenerator.

Paragraph (b) provides that an electric utility may discontinue purchases from a qualifying facility during a system emergency if such purchases would contribute to the emergency. In addition, during system emergencies, a qualifying facility must be treated on a nondiscriminatory basis in any load

shedding program—i.e., on the same basis that other customers of a similar class with similar load characteristics are treated with regard to interruption of service.

Credit for capacity (as noted in § 292.304(e)(2)(v)) will also take into account the ability of the qualifying facility to separate its load and generation during system emergencies. However, the qualifying facility may well be eligible for some capacity credit even if it cannot separate its load and generation.

§ 292.308 Standards for operating reliability.

Section 210(a) of PURPA states that the rules requiring electric utilities to buy from and sell to qualifying facilities shall include provisions respecting minimum reliability of qualifying facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric utilities during emergencies. The Commission believes that the reliability of qualifying facilities can be accounted for through price; namely, the less reliable a qualifying facility might be, the less it should be entitled to receive for purchases from it by the utility.

As a result, the Commission has not included specific standards relating to the reliability in the sense of the ability of qualifying facilities to provide energy or capacity.

The Commission has determined that safety equipment exists which can ensure that qualifying facilities do not energize utility lines during utility outages. This section accordingly provides that each State regulatory authority or nonregulated electric utility may establish standards for interconnected operation between electric utilities and qualifying facilities. These standards may be recommended by any utility, any qualifying facility, or any other person. These standards must be accompanied by a statement showing the need for the standard on the basis of system safety and operating requirements.

Subpart D—Implementation

Summary of this Subpart

Rules in this subpart are intended to carry out the responsibility of the Commission to encourage cogeneration and small power production by clarifying the nature of the obligation to implement the Commission's rules under section 210.

These rules afford the State regulatory authorities and nonregulated electric utilities great latitude in determining the manner of implementation of the

Commission's rules, provided that the manner chosen is reasonably designed to implement the requirements of Subpart C. The Commission recognizes that many States and individual nonregulated electric utilities have ongoing programs to encourage small power production and cogeneration. The Commission also recognizes that economic and regulatory circumstances vary from State to State and utility to utility. It is within this context—in recognition of the work already begun and of the variety of local conditions—that the Commission promulgates its regulations requiring implementation of rules issued under section 210.

Because of the Commission's desire not to create unnecessary burdens at the State level, these rules provide a procedure whereby a State regulatory authority or nonregulated electric utility may apply to the Commission for a waiver if it can demonstrate that compliance with certain requirements of Subpart C is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210.

Several commenters expressed their concern that State regulatory authorities would not be able adequately to implement the Commission's rules, and therefore, recommended that the Commission issue specific rules which the State regulatory authorities would adopt without change. The Commission does not find this proposal to be appropriate at this time, and believes that providing an opportunity for experimentation by the States is more conducive to development of these difficult rate principles.

Implementation

Section 210(f) of PURPA requires that within one year after the date that this Commission prescribes its rules under subsection (a), and within one year of the date any of these rules is revised, each State regulatory authority and each nonregulated electric utility, after notice and opportunity for hearing, must implement the rules or revisions thereof, as the case may be.

The obligation to implement section 210 rules is a continuing obligation which begins within one year after promulgation of such rules. The requirement to implement may be fulfilled either (1) through the enactment of laws or regulations at the State level, (2) by application on a case-by-case basis by the State regulatory authority, or nonregulated utility, of the rules adopted by the Commission, or (3) by any other action reasonably designed to implement the Commission's rules.

Review and Enforcement

Section 210(g) of PURPA provides one of the means of obtaining judicial review of a proceeding conducted by a State regulatory authority or nonregulated utility for purposes of implementing the Commission's rules under section 210. Under subsection (g), review may be obtained pursuant to procedures set forth in section 123 of PURPA. Section 123(c)(1) contains provisions concerning judicial review and enforcement of determinations made by State regulatory authorities and nonregulated utilities under Subtitle A, B, or C of Title I in the appropriate State court. These provisions also apply to review of any action taken to implement the rules under section 210. This means that persons can bring an action in State court to require the State regulatory authorities or nonregulated utilities to implement these regulations.

Section 123(c)(2) of PURPA provides that persons seeking review of any determination made by a Federal agency may bring an action in the appropriate Federal court. This distinction between Federal agencies and non-Federal agencies also applies to review of enforcement of the implementation of the rules under section 210.

Finally, the Commission believes that review and enforcement of implementation under section 210 of PURPA can consist not only of review and enforcement as to whether the State regulatory authority or nonregulated electric utility has conducted the initial implementation properly—namely, put into effect regulations implementing section 210 rules or procedures for that implementation, after notice and an opportunity for a hearing. It can also consist of review and enforcement of the application by a State regulatory authority or nonregulated electric utility, on a case-by-case basis, of its regulations or of any other provision it may have adopted to implement the Commission's rules under section 210.

Section 210(h)(2)(A) of PURPA states that the Commission may enforce the implementation of regulations under section 210(f). The Congress has provided not only for private causes of action in State courts to obtain judicial review and enforcement of the implementation of the Commission's rules under section 210, but also provided that the Commission may serve as a forum for review and enforcement of the implementation of this program.

§ 292.401 Implementation by state regulatory authorities and nonregulated electric utilities

Paragraph (a) of § 292.401 sets forth the obligation of each State regulatory authority to commence implementation of Subpart C within one year of the date these rules take effect. In complying with this paragraph the State regulatory authorities are required to provide for notice of and opportunity for public hearing. As described in the summary of this subpart, such implementation may consist of the adoption of the Commission's rules, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement Subpart C.

This section does not cover one provision of Subpart C which is not required to be implemented by the State regulatory authority or nonregulated electric utility. This provision is § 292.302 (Availability of electric utility system cost data), the implementation of which is subject to § 292.402, discussed below.

Subsection (b) sets forth the obligation of each nonregulated electric utility to commence, after notice and opportunity for public hearing, implementation of Subpart C. The nonregulated electric utilities, being both the regulator and the utility subject to the regulation, may satisfy the obligation to commence implementation of Subpart C through issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement that subpart.

Paragraph (c) sets forth a reporting requirement under which each State regulatory authority and nonregulated electric utility is to file with the Commission, not later than one year after these rules take effect, a report describing the manner in which it is proceeding to implement Subpart C.

Comments received regarding this section indicated a concern that the obligation of a State regulatory authority or nonregulated utility "to commence implementation * * * within one year * * *" did not provide any guidance as to when the process must be completed. The Commission notes that the intention of this section is that the State regulatory authorities and nonregulated utilities have one year in which to establish procedures and that at the end of that year each State must be prepared to entertain applications. The phrase "commence implementation" is intended by the Commission to connote that implementation of these rules is a

continuing process and that oversight will be ongoing.

§ 292.402 Implementation of reporting objectives.

The obligation to comply with § 292.302 is imposed directly on electric utilities. This is different from the rest of Subpart C where the obligation to act is imposed on the State regulatory authority or the nonregulated electric utility in its role as regulator. The Commission is exercising its authority under section 133 of PURPA and other laws within the Commission's authority to require this reporting.

Any electric utility which fails to comply with the requirements of § 292.302(b) is subject to the same penalties as it might receive as a result of a failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA. As stated earlier in this preamble, the data required by § 292.302 will form the basis from which the rates for purchases will be derived; § 292.302 is thus a critical element in this program. The Commission believes that, with regard to utilities subject to section 133 of PURPA, the Commission may exercise its authority under section 133 to require the data required by § 292.302(b) on the basis that the Commission finds such information necessary to allow determination of the costs associated with providing electric services. With regard to utilities not subject to section 133, if they fail to provide the data called for in § 292.302(c), the Commission may compel its production under the Federal Power Act and other statutes which provide the Commission with authority to require reporting of such data.

§ 292.403 Waivers.

Paragraph (a) provides for a procedure by which any State regulatory authority or nonregulated electric utility may apply for a waiver from the application of any of the requirements of Subpart C other than § 292.302. (Section 292.302(d) has been revised to permit a State regulatory authority or nonregulated utility to adopt a substitute method for the provision of system cost data without prior Commission approval.)

Paragraph (b) provides that the Commission will grant such a waiver only if the applicant can show that compliance with any of the requirements is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210 of PURPA.

This section is included in recognition of the need for the Commission to afford

flexibility to the States and nonregulated utilities to implement the Commission's rules under section 210.

Several comments suggested that the Commission set forth procedures for considering applications for waivers which would allow formal participation by qualifying facilities in a public hearing. The Commission notes that interested parties would be given an opportunity to be heard in any proceeding it conducts to determine whether or not a waiver should be granted.

Subpart F—Exemption of Qualifying Small Power Production and Cogeneration Facilities From Certain Federal and State Laws and Regulations

§ 292.601 Exemption of qualifying facilities from the Federal Power Act.

Section 210(e) of PURPA states that the Commission shall prescribe rules under which qualifying facilities are exempt, in part, from the Federal Power Act, from the Public Utility Holding Company Act of 1935, from the State laws and regulations respecting the rates, or respecting the financial or organization regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production. As noted in the Staff Discussion Paper, the Congress intended the Commission to make liberal use of its exemption authority in order to remove the disincentive of utility-type regulation. The Commission believes that broad exemption is appropriate.

Section 210(e)(2) of PURPA provides that the Commission is not authorized to exempt small power production facilities of 30 to 80 megawatt capacity from these laws. An exception is made for small power production facilities using biomass as a primary energy source. Such facilities between 30 and 80 megawatts may be exempted from the Public Utility Holding Company Act of 1935 and from State laws and regulations but may not be exempted from the Federal Power Act. The Commission will establish procedures for the determination of rates for these facilities in a separate proceeding.

Paragraph (a) sets forth those facilities which are eligible for exemption. Paragraph (b) provides that facilities described in paragraph (a) shall be exempted from all but certain specified sections of the Federal Power Act.

Section 210(e)(3)(C) of PURPA provides that no qualifying facility may be exempted from any license or permit

requirement under Part I of the Federal Power Act. Accordingly, no qualifying facilities will be exempt from Part I of the Federal Power Act. The Commission recently issued simplified procedures for obtaining water power licenses for hydroelectric projects of 1.5 megawatts or less, and has issued proposed regulations to expedite licensing of existing facilities.²¹

The Commission believes cogeneration and small power production facilities could be the subject of an order under section 202(c) of the Federal Power Act requiring them to provide energy if the Economic Regulatory Administration determines that an emergency situation exists. Because application of this section is limited to emergency situations and is not affected by the fact that a facility attains qualifying status or engages in interchanges with an electric utility, the Commission notes that qualifying facilities will not be exempted from section 202(c) of the Act.

Furthermore, in response to comment, the Commission has revised this paragraph to provide that qualifying facilities are not exempt from sections 210, 211, and 212 of the Federal Power Act, as required by section 210(e)(3)(B) of PURPA.

Sections 203, 204, 205, 206, 208, 301, 302, and 304 of the Federal Power Act reflect traditional rate regulation or regulation of securities of public utilities. The Commission has determined that qualifying facilities shall be exempted from these sections of the Federal Power Act.

Section 305(c) of the Act imposes certain reporting requirements on interlocking directorates. The Commission believes that any person who otherwise is required to file a report regarding interlocking positions should not be exempted from such requirement because he or she is also a director or officer of a qualifying facility.

Finally, the enforcement provisions of Part III of the Federal Power Act will continue to apply with respect to the sections of the Federal Power Act from which qualifying facilities are not exempt.

§ 292.602 Exemption of qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.

Under section 210(e) of PURPA the Commission can exempt qualifying facilities from regulation under the

²¹See Order No. 11, Simplified Procedures for Certain Water Power Licenses, Docket No. RM79-9, issued September 5, 1978, and Application for License for Major Projects—Existing Dam, Docket No. RM79-36, 44 FR 24095 (April 21, 1979).

Public Utility Holding Company Act of 1935 and State laws and regulations concerning rates or financial organization. Only cogeneration facilities and small power production facilities of 30 megawatts or less may be exempted from both of these laws, with the exception that any qualifying small power production facility (*i.e.*, up to 80 megawatts) using biomass as a primary energy source can be exempted from these laws.

The Commission has determined that where a qualifying facility is subjected to more stringent regulation than other companies solely by reason of the fact that it is engaged in the production of electric energy, these more stringent requirements should be eased through exemption of qualifying facilities. By excluding any qualifying facility from the definition of an "electric utility company" under section 2(a)(3) of the Public Utility Holding Company Act of 1935, such facilities would be removed from Public Utility Holding Company Act regulation which is applied exclusively to electric utility companies. Moreover, by excluding qualifying facilities from this definition, parent companies of qualifying facilities would not be subject to additional regulation as a result of electric production by their subsidiaries. The Commission therefore believes that in order to encourage cogeneration and small power production it is necessary to exempt cogenerators and small power producers from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities.

Accordingly, paragraph (b) states that no qualifying facility shall be considered to be an "electric utility company", as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(a)(3).

Section 210(e) of PURPA states that qualifying facilities which may be exempted from the Public Utility Holding Company Act may also be exempted from State laws and regulations respecting the rates or financial organization of electric utilities.

The Commission has decided to provide a broad exemption from State laws and regulations which would conflict with the State's implementation of the Commission's rules under section 210.

The Commission believes that such broad exemption is necessary to encourage cogeneration or small power production. Accordingly, subparagraph (c)(1) provides that any qualifying facility shall be exempt from State laws and regulations respecting rates of electric utilities, and from financial and

organizational regulation of electric utilities. Several commenters noted that this section might be interpreted as exempting qualifying facilities from state laws or regulations implementing the Commission's rules, under section 210(f) of PURPA. In order to clarify that qualifying facilities are not to be exempt from these rules, the Commission has added subparagraph (c)(2) prohibiting any exemptions from State laws and regulations promulgated pursuant to Subpart C of these rules.

Some commenters indicated that § 292.301(b)(1) might be interpreted as prohibiting a State from reviewing contracts for purchases. These commenters stated that, as a part of a State's regulation of electric utilities, a State regulatory authority needs to be able to review contracts entered into by electric utilities it regulates.

These rules, and the exemptions being provided by these rules, are not intended to divest a State regulatory agency of its authority under State law to review contracts for purchases as part of its regulation of electric utilities. Such authority may continue to be exercised if consistent with the terms, policies and practices under sections 210 and 201 of PURPA and this Commission's implementing regulations. If the authority or its exercise is in conflict with these sections of PURPA or the Commission's regulations thereunder, the State must yield to the Federal requirements. The Commission does not believe it possible or advisable to attempt to establish more precise guidelines than these. Accordingly, States which have questions in this regard should seek an interpretive ruling from the Commission's General Counsel.

Subparagraph (c)(3) provides that, upon request of a State regulatory authority or nonregulated electric utility, the Commission may limit the applicability of the broad exemption from the State laws. This provision is intended to add flexibility to the exemption.

The Commission perceives that there may be instances in which a qualifying facility would wish to have an interpretation of whether or not it is subject to a particular State law in order to remove any uncertainty. Under subparagraph (c)(4), the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

(Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601, *et seq.*, Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 Fed. Reg. 46267)

IV. Effective Date

The regulations promulgated in this order are effective March 20, 1980.

In consideration of the foregoing, the Commission amends Part 292 of Chapter I, Title 18, Code of Federal Regulations, as set forth below, effective March 20, 1980. By the Commission.

Kenneth F. Plumb,
Secretary.

(1) Subchapter K is amended in the table of contents and in the text of the regulation by deleting the title for Part 292 and substituting the following in lieu thereof:

Part 292—Regulations Under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978 With Regard to Small Power Production and Cogeneration.

(2) Subchapter K is further amended in the table of contents to Part 292 and in the text of the regulations by reserving Subpart B and by adding new Subparts A, C, D, and F to read as follows:

PART 292—REGULATIONS UNDER SECTIONS 201 AND 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978 WITH REGARD TO SMALL POWER PRODUCTION AND COGENERATION.

Subpart A—General Provisions

Sec.
292.101 Definitions.

Subpart B—[Reserved]

Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

292.301 Scope.
292.302 Availability of Electric Utility System Cost Data.
292.303 Electric Utility Obligations Under This Subpart.
292.304 Rates for Purchases.
292.305 Rates for Sales.
292.306 Interconnection Costs.
292.307 System Emergencies.
292.308 Standards for Operating Reliability.

Subpart D—Implementation

292.401 Implementation by State Regulatory Authorities and Nonregulated Utilities.
292.402 Implementation of Certain Reporting Requirements.
292.403 Waivers.
* * *

Subpart F—Exemption of Qualifying Small Power Production Facilities and Cogeneration Facilities From Certain Federal and State Laws and Regulations

292.601 Exemption of Qualifying Facilities from the Federal Power Act.
292.602 Exemption of Qualifying Facilities From the Public Utility Holding Company

Act and Certain State Law and Regulation.

Authority: This part issued under the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601 *et seq.*, Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 FR 46267.

Subpart A—General Provisions

§ 292.101 Definitions.

(a) *General rule.* Terms defined in the Public Utility Regulatory Policies Act of 1978 (PURPA) shall have the same meaning for purposes of this part as they have under PURPA, unless further defined in this part.

(b) *Definitions.* The following definitions apply for purposes of this part.

(1) "Qualifying facility" means a cogeneration facility or a small power production facility which is a qualifying facility under Subpart B of this part of the Commission's regulations.

(2) "Purchase" means the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

(3) "Sale" means the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

(4) "System emergency" means a condition on a utility's system which is likely to result in imminent significant disruption of service to customers or is imminently likely to endanger life or property.

(5) "Rate" means any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

(7) "Interconnection costs" means the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead

generated an equivalent amount of electric energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection costs do not include any costs included in the calculation of avoided costs.

(8) "Supplementary power" means electric energy or capacity supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

(9) "Back-up power" means electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility.

(10) "Interruptible power" means electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

(11) "Maintenance power" means electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

Subpart B—[Reserved]

Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

§ 292.301 Scope.

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) Limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

§ 292.302 Availability of electric utility system cost data.

(a) *Applicability.* (1) Except as provided in paragraph (a)(2) of this section, paragraph (b) applies to each electric utility, in any calendar year, if the total sales of electric energy by such utility for purposes other than resale exceeded 500 million kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

(2) Each utility having total sales of electric energy for purposes other than

resale of less than one billion kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding year, shall not be subject to the provisions of this section until May 31, 1982.

(b) *General rule.* To make available data from which avoided costs may be derived, not later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter, each regulated electric utility described in paragraph (a) of this section shall provide to its State regulatory authority, and shall maintain for public inspection, and each nonregulated electric utility described in paragraph (a) of this section shall maintain for public inspection, the following data:

(1) The estimated avoided cost on the electric utility's system, solely with respect to the energy component, for various levels of purchases from qualifying facilities. Such levels of purchases shall be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than 10 percent of the system peak demand for systems of less than 1000 megawatts. The avoided costs shall be stated on a cents per kilowatt-hour basis, during daily and seasonal peak and off-peak periods, by year, for the current calendar year and each of the next 5 years;

(2) The electric utility's plan for the addition of capacity by amount and type, for purchases of firm energy and capacity, and for capacity retirements for each year during the succeeding 10 years; and

(3) The estimated capacity costs at completion of the planned capacity additions and planned capacity firm purchases, on the basis of dollars per kilowatt, and the associated energy costs of each unit, expressed in cents per kilowatt hour. These costs shall be expressed in terms of individual generating units and of individual planned firm purchases.

(c) Special rule for small electric utilities.

(1) Each electric utility (other than any electric utility to which paragraph (b) of this section applies) shall, upon request:

(i) Provide comparable data to that required under paragraph (b) of this section to enable qualifying facilities to estimate the electric utility's avoided costs for periods described in paragraph (b) of this section; or

(ii) With regard to an electric utility which is legally obligated to obtain all its requirements for electric energy and capacity from another electric utility, provide the data of its supplying utility

and the rates at which it currently purchases such energy and capacity.

(2) If any such electric utility fails to provide such information on request, the qualifying facility may apply to the State regulatory authority (which has ratemaking authority over the electric utility) or the Commission for an order requiring that the information be provided.

(d) Substitution of alternative method.

(1) After public notice in the area served by the electric utility, and after opportunity for public comment, any State regulatory authority may require (with respect to any electric utility over which it has ratemaking authority), or any non-regulated electric utility may provide, data different than those which are otherwise required by this section if it determines that avoided costs can be derived from such data.

(2) Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated utility which requires such different data shall notify the Commission within 30 days of making such determination.

(e) State Review. (1) Any data submitted by an electric utility under this section shall be subject to review by the State regulatory authority which has ratemaking authority over such electric utility.

(2) In any such review, the electric utility has the burden of coming forward with justification for its data.

§ 292.303 Electric utility obligations under this subpart.

(a) Obligation to purchase from qualifying facilities. Each electric utility shall purchase, in accordance with § 292.304, any energy and capacity which is made available from a qualifying facility:

- (1) Directly to the electric utility; or
- (2) Indirectly to the electric utility in accordance with paragraph (d) of this section.

(b) Obligation to sell to qualifying facilities. Each electric utility shall sell to any qualifying facility, in accordance with § 292.305, any energy and capacity requested by the qualifying facility.

(c) Obligation to interconnect. (1) Subject to paragraph (c)(2) of this section, any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

(2) No electric utility is required to interconnect with any qualifying facility if, solely by reason of purchases or sales

over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act.

(d) Transmission to other electric utilities. If a qualifying facility agrees, an electric utility which would otherwise be obligated to purchase energy or capacity from such qualifying facility may transmit the energy or capacity to any other electric utility. Any electric utility to which such energy or capacity is transmitted shall purchase such energy or capacity under this subpart as if the qualifying facility were supplying energy or capacity directly to such electric utility. The rate for purchase by the electric utility to which such energy is transmitted shall be adjusted up or down to reflect line losses pursuant to § 292.304(e)(4) and shall not include any charges for transmission.

(e) Parallel operation. Each electric utility shall offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with any applicable standards established in accordance with § 292.308.

§ 292.304 Rates for purchases.

(a) Rates for purchases. (1) Rates for purchases shall:

- (i) Be just and reasonable to the electric consumer of the electric utility and in the public interest; and
- (ii) Not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) Relationship to avoided costs. (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to paragraph (b)(3) of this section, a rate for purchases satisfies the requirements of paragraph (a) of this section if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e) of this section.

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a) of this section, and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with paragraph (b)(2) of this section.

regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) Standard rates for purchases. (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

- (i) Shall be consistent with paragraphs (a) and (e) of this section; and
- (ii) May differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) Purchases "as available" or pursuant to a legally enforceable obligation. Each qualifying facility shall have the option either:

(1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

- (i) The avoided costs calculated at the time of delivery; or
- (ii) The avoided costs calculated at the time the obligation is incurred.

(e) Factors affecting rates for purchases. In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) The data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) The availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

- (i) The ability of the utility to dispatch the qualifying facility;
- (ii) The expected or demonstrated reliability of the qualifying facility;

(iii) The terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) The extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) The usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) The individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) The smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) The relationship of the availability of energy or capacity from the qualifying facility as derived in paragraph (e)(2) of this section, to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) The costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to paragraph (f)(2) of this section will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke paragraph (f)(1) of this section must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of paragraph (f)(2) of this section will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in paragraph (f)(1) of this section not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State

regulatory authority determines necessary or appropriate, either before or after the occurrence.

§ 292.305 Rates for sales.

(a) *General rules.* (1) Rates for sales:

(i) Shall be just and reasonable and in the public interest; and

(ii) Shall not discriminate against any qualifying facility in comparison to rates for sales to other customers served by the electric utility.

(2) Rates for sales which are based on accurate data and consistent systemwide costing principles shall not be considered to discriminate against any qualifying facility to the extent that such rates apply to the utility's other customers with similar load or other cost-related characteristics.

(b) *Additional Services to be Provided to Qualifying Facilities.* (1) Upon request of a qualifying facility, each electric utility shall provide:

(i) Supplementary power;

(ii) Back-up power;

(iii) Maintenance power; and

(iv) Interruptible power.

(2) The State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and the Commission (with respect to any nonregulated electric utility) may waive any requirement of paragraph (b)(1) of this section if, after notice in the area served by the electric utility and after opportunity for public comment, the electric utility demonstrates and the State regulatory authority or the Commission, as the case may be, finds that compliance with such requirement will:

(i) Impair the electric utility's ability to render adequate service to its customers; or

(ii) Place an undue burden on the electric utility.

(c) *Rates for sales of back-up and maintenance power.* The rate for sales of back-up power or maintenance power:

(1) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities on an electric utility's system will occur simultaneously, or during the system peak, or both; and

(2) shall take into account the extent to which scheduled outages of the qualifying facilities can be usefully coordinated with scheduled outages of the utility's facilities.

§ 292.306 Interconnection costs.

(a) *Obligation to pay.* Each qualifying facility shall be obligated to pay any interconnection costs which the State

regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis with respect to other customers with similar load characteristics.

(b) *Reimbursement of interconnection costs.* Each State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and nonregulated utility shall determine the manner for payments of interconnection costs, which may include reimbursement over a reasonable period of time.

§ 292.307 System emergencies.

(a) *Qualifying facility obligation to provide power during system emergencies.* A qualifying facility shall be required to provide energy or capacity to an electric utility during a system emergency only to the extent:

(1) Provided by agreement between such qualifying facility and electric utility; or

(2) Ordered under section 202(c) of the Federal Power Act.

(b) *Discontinuance of purchases and sales during system emergencies.* During any system emergency, an electric utility may discontinue:

(1) Purchases from a qualifying facility if such purchases would contribute to such emergency; and

(2) Sales to a qualifying facility, provided that such discontinuance is on a nondiscriminatory basis.

§ 292.308 Standards for operating reliability.

Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may establish reasonable standards to ensure system safety and reliability of interconnected operations. Such standards may be recommended by any electric utility, any qualifying facility, or any other person. If any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility establishes such standards, it shall specify the need for such standards on the basis of system safety and reliability.

Subpart D—Implementation

§ 292.401 Implementation by State regulatory authorities and nonregulated electric utilities.

(a) *State regulatory authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence

implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(b) *Nonregulated electric utilities.* Not later than one year after these rules take effect, each nonregulated electric utility shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(c) *Reporting requirement.* Not later than one year after these rules take effect, each State regulatory authority and nonregulated electric utility shall file with the Commission a report describing the manner in which it will implement Subpart C (other than § 292.302 thereof).

§ 292.402 Implementation of certain reporting requirements.

Any electric utility which fails to comply with the requirements of § 292.302(b) shall be subject to the same penalties to which it may be subjected for failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA.

§ 292.403 Waivers.

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C (other than § 292.302 thereof).

(b) *Commission action.* The Commission will grant such a waiver only if an applicant under paragraph (a) of this section demonstrates that compliance with any of the requirements of Subpart C is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

Subpart F—Exemption of Qualifying Small Power Production Facilities and Cogeneration Facilities from Certain Federal and State Laws and Regulations

§ 292.601 Exemption to qualifying facilities from the Federal Power Act.

(a) *Applicability.* This section applies to:

- (1) qualifying cogeneration facilities; and
- (2) qualifying small power production facilities which have a power production capacity which does not exceed 30 megawatts.

(b) *General rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except:

- (1) Sections 1-30;
- (2) Sections 202(c), 210, 211, and 212;
- (3) Sections 305(c); and
- (4) Any necessary enforcement provision of Part III with regard to the sections listed in paragraphs (b) (1), (2) and (3) of this section.

§ 292.602 Exemption to qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.

(a) *Applicability.* This section applies to any qualifying facility described in § 292.601(a), and to any qualifying small power production facility with a power production capacity over 30 megawatts if such facility produces electric energy solely by the use of biomass as a primary energy source.

(b) *Exemption from the Public Utility Holding Company Act of 1935.* A qualifying facility described in paragraph (a) shall not be considered to be an "electric utility company" as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79b(a)(3).

(c) *Exemption from certain State law and regulation.*

- (1) Any qualifying facility shall be exempted (except as provided in paragraph (c)(2)) of this section from State law or regulation respecting:
 - (i) The rates of electric utilities; and
 - (ii) The financial and organizational regulation of electric utilities.
- (2) A qualifying facility may not be exempted from State law and regulation implementing Subpart C.

(3) Upon request of a State regulatory authority or nonregulated electric utility, the Commission may consider a limitation on the exemptions specified in subparagraph (1).

(4) Upon request of any person, the Commission may determine whether a

qualifying facility is exempt from a particular State law or regulation.

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24126 Wednesday, April 9, 1980

18 CFR Part 292

(Docket No. RM79-55)

Rates and Exemptions for Qualifying Small Power Production and Cogeneration Facilities; Correction

April 3, 1980.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Erratum notice.

SUMMARY: This notice contains a correction of § 292.302 (a) and (b) of the Federal Energy Regulatory Commission's final regulations.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION: In the Federal Energy Regulatory Commission's Final Regulations, issued February 19, 1980, entitled Regulations Under Section 210 of the Public Utility Regulatory Policies Act of 1978 (45 FR 12214, February 25, 1980), at 45 FR 12234, in § 292.302 (a) and (b), the reference to May 31, 1982 should be changed to June 30, 1982. This revision will accurately carry out the Commission's intent, as stated in the preamble to the rule, to "conform to the dates required by the

Commission's regulations implementing section 133 of PURPA."

Kenneth F. Plumb,
Secretary.

(FR Doc. 80-10786 Filed 4-8-80; 8:15 am)

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