E-ALERT | Clean Energy and Climate

November 1, 2010

FERC PROMOTES DEVELOPMENT OF NEW GENERATION RESOURCES BY PROVIDING SIGNIFICANT FLEXIBILITY FOR STATE FEED-IN TARIFFS

In an October 21, 2010 order addressing a state's flexibility in implementing a feed-in tariff program, FERC clarified how a state can encourage development of new electricity generation resources in a way that does not conflict with federal laws and regulations. Specifically, FERC ruled that a multi-tiered resource approach for Qualifying Facilities (QFs) in which a state sets different rate levels for different types of QF resources could be acceptable without violating FERC's exclusive authority to set wholesale electricity rates. In addition, FERC ruled that a rate adder to reflect the avoided costs of distribution or transmission system upgrades can also be acceptable.

FERC's policy findings came in connection with certain clarifications to an earlier order regarding California's feed-in tariff program requiring utilities to purchase power at established rates from combined heat and power (CHP) generators of 20 MWs or less. Utilities had challenged the program as intruding into FERC's exclusive jurisdiction to regulate rates for sales for resale in interstate commerce. In a July 15, 2010 order, FERC found that the California Public Utility Commission's (CPUC) program did indeed constitute impermissible wholesale rate-setting but would not be preempted if: (1) the generators are Qualifying Facilities (QFs) under PURPA; and (2) the purchase rate does not exceed the avoided cost of the purchasing utility.

In addressing the CPUC's request for certain clarifications, FERC made the following two significant policy determinations:

A multi-tiered avoided cost rate structure can be consistent with the avoided cost rate requirements set forth in PURPA and FERC's regulations.

The CPUC asked whether it may implement a two-tiered rate structure, where QFs compliant with certain state standards receive rates based on higher, long-run avoided cost rates reflecting more stringent efficiency standards, and non-compliant QFs continue to receive rates based on lower short-run avoided costs. In its affirmative answer, FERC noted that its regulations define "avoided costs" as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility…such utility would generate itself or purchase from another source." It also noted that according to its regulations, avoided cost rates may also "differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies."

FERC then focused on the question of what costs the utility is avoiding. According to the order, when determining avoided cost, a state may: 1) determine that capacity is being avoided; 2) take into account the cost of the next marginal unit of generation; and 3) consider obligations imposed by the state (for example, that utilities must purchase energy from particular sources of energy or for a long duration). FERC also said that it has long held that states are allowed "a wide degree of latitude" in establishing an implementation plan for PURPA, as long as such plans are consistent with FERC regulations, and, because those determinations are fact-specific based on many factors, FERC is "reluctant to second guess the state commission's determinations."

An adder or bonus to an avoided cost rate for resources located in transmission-constrained areas may be acceptable if based on avoided transmission costs.

The CPUC stated that, for CHP systems located in transmission-constrained areas, there should be a 10 percent rate adder to reflect the avoided costs of the construction of distribution and transmission upgrades that would otherwise be needed. FERC noted that it had previously found that an avoided cost rate may not include a bonus or adder above the calculated avoided cost to provide additional compensation for, for example, environmental externalities above avoided costs. But, if the environmental costs are real costs that would be incurred by utilities, then they may be accounted for in a determination of avoided cost rates. Thus, if the avoided cost adder or bonus is based on an actual determination of the expected costs of upgrades to the distribution or transmission system that the QFs will permit the purchasing utility to avoid, then it would constitute an actual avoided cost determination and be consistent with PURPA and FERC's regulations.

The Commission also noted that this order does not address whether the CPUC's offer price under its program is consistent with the avoided cost rate treatment of PURPA, nor whether the specific amount of 10 percent for the adder is justified by avoided costs.

The Commission's order is available here.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our clean energy and climate practice group:

William Massey	202.662.5322	wmassey@cov.com
Robert Fleishman	202.662.5523	rfleishman@cov.com
Gerard Waldron	202.662.5360	gwaldron@cov.com
Bud Earley	202.662.5434	bearley@cov.com