

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Regulations Governing Small Power
Production And Cogeneration Facilities

Docket No. RM05-36-000

**Comments of the
Electricity Consumers Resource Council (“ELCON”) and American Iron and
Steel Institute (“AISI”)**

The Electricity Consumers Resource Council (ELCON) and the American Iron and Steel Institute (AISI) (Industrial Consumers) appreciate the opportunity to submit comments in response to the Commission’s October 11, 2005, Notice of Proposed Rulemaking on proposed rules implementing its renew authority to revise its rules applicable to governing qualifying facilities (QFs) under the Energy Policy Act of 2005 (EPAct 2005).

Many member companies own and operate cogeneration facilities that are QFs under the Public Utility Regulatory Policies Act of 1978 (PURPA). These facilities are an integral part of each company’s manufacturing process.

I. SUMMARY OF COMMENTS

In general, FERC’s NOPR represents a faithful implementation of the new law’s statutory requirements. In a few respects, however, FERC goes beyond the mandate of EPAct 2005 and suggests an erosion of PURPA benefits/QF rights that is ill-advised. PURPA has not been repealed and its purposes remain vital to assuring an important source of non-utility

generation competition as well as promoting energy and economic efficiencies. In particular Industrial Consumers recommend:

-- FERC proposes to subject QFs for the first time to its market based rate approval process, in lieu of the current exemption that QFs enjoy from the Federal Power Act (FPA). While QFs with majority ownership by transmission – owning utilities should be subject to market-based rate analysis rather than exemption, independent QFs should continue to be able to sell at market-based rates under the existing exemption. To do otherwise is an unnecessary regulatory burden on QFs, which is inconsistent with the statute, as it would needlessly discourage QFs without serving competing FPA objectives.

-- The criteria for certifying QFs should be clarified such that larger QFs are not disabled from QF status as size may be essential for capturing the greatest efficiencies. A facility should be deemed fundamentally a QF based on its useful heat utilization dedicated to a commercial or industrial purpose and the facility's overall efficiency.

-- FERC should be wary of claims regarding the potential for new, so-called "PURPA machines." Past efforts of states to bolster the development of renewable resources with exaggerated estimates of utilities' avoided costs have run its course, and other non-PURPA related incentives are now the rule. Instead, FERC should dismiss arguments to tighten the PURPA rules for non-utility owned QFs because the hidden motive is the restoration of pre-PURPA conditions that squelch competition.

-- FERC should clarify the definition of "new QFs." The statutory provisions which grandfather existing QFs should not be evaded where a mere change in ownership occurs.

II. FERC'S NOPR PROPOSAL

A. Rules Applicable To New QF Qualification

Pursuant to Section 1253(a) of EPAct 2005, the proposed rule would impose conditions on new cogeneration QFs so as to apply the regulatory benefits only to facilities truly designed to save energy:

-- Thermal output must be used in productive and beneficial manner, thereby ending the Commission's prior "presumptively useful" standard. The stated purpose is to make sure that the thermal output is for a "genuine and legitimate purpose" and not a "sham." The Commission will consider the uses to which the product produced by the thermal output is put, whether the product is needed and whether there is a market. Favorable to QFs, the preamble states that the Commission will apply a presumption of usefulness, but as required by the statute such presumption will no longer be irrebutable.

-- Electrical, thermal, chemical and mechanical output must be used fundamentally for industrial, commercial or institutional purposes. The Commission states that it will consider whether the facility is sized to meet the needs of its host rather than for sale of electric output to electric utilities, and it will more closely scrutinize facilities that only minimally satisfy its operating standards. The Commission requests comment on whether it should require a specified percentage of the total energy output used for industrial, commercial or institutional purposes rather than for sale to electric utilities.

-- Continuing progress must be shown in the development of efficient electric energy generating technology. The Commission will require applications to "demonstrate their employment of efficient, modern technologies."

-- Although not required by EPCRA 2005, the Commission also proposes to apply efficiency standards to new coal-burning cogeneration facilities similar to that applied to natural gas and oil burning cogeneration facilities, and it requests comment on what the standards should be.

B. Proposal To Withdraw FPA Exemptions For QFs

Pursuant to Section 1253(b) of EPCRA 2005, the proposed rule would eliminate QF ownership limitations to persons not primarily engaged in the generation or sale of electric power, so that QFs could be owned by traditional utilities.

In another aspect of the proposed rule not statutorily required, the Commission proposes to cut back on the traditional exemptions from the FPA previously granted to QFs. In particular, the Commission proposes to eliminate the exemption for market-based sales by QFs – those not made pursuant to a state’s avoided-cost ratemaking regime. Instead, such market-based sales would be subject to the FPA Section 205/206 rate filing provisions. The NOPR preamble states that the proposed elimination of ownership restrictions heightens concern that market-based sales by large QF units could potentially have a significant market effect. The Commission requests comment on whether the exemption should be retained for small QFs (<5 MW) or for QFs that are independent of traditional utilities, transmission providers and other power producers, and on whether the exemption from other sections of the FPA should be eliminated or retained.

III. BACKGROUND ON THE PURPOSES OF PURPA

The intent of Title II of the 1978 PURPA was a desire by Congress to encourage the development of certain types of alternative power supplies as a means of improving the overall efficiency of electric power supply, reducing dependency on oil and natural gas in electricity generation, and providing a greater diversity in the nation’s sources of electric power supply.

These alternative supplies were designated in the Act as “qualifying facilities” or QFs, which included both cogeneration and small power production.

The principle obstacles Congress perceived to the development of QFs in the absence of legislation were (a) reluctance of electric utilities to deal with non-utility generators including industrial self-generation or cogeneration, (b) the difficulties encountered by project developers in negotiating power sales contracts with utilities under terms and conditions that made such projects economically viable, and (c) the unwillingness of potential developers to be subjected to economic regulation as public utilities.¹ Eighteen years after the enactment of PURPA, the threat of these same forms of discrimination remain.

Provisions in Title II that attempted to mitigate these obstacles are:²

-- Utilities are required to purchase electricity generated by QFs at rates based on the utility’s incremental (or “avoided”) costs and are “just and reasonable to the consumers of the utility, in the public interest, and nondiscriminatory.”

-- Utilities must provide backup service to QFs at rates that are both “just and reasonable to the consumers of the utility” and that are in the “public interest.”

-- Utilities are also required to interconnect with QFs and offer to operate the interconnection under reasonable terms and conditions consistent with reliable system operation.

-- FERC was given discretionary authority to exempt QFs from state and federal regulations including the Public Utility Holding Company Act, if it determines that such exemptions are necessary to encourage cogeneration and small power production.

¹ See Energy Information Administration, Cogeneration: Regulation, Economics and Capacity, DOE/NBB-0031, April 1983.

² PURPA Section 210. Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 95th Cong. 2d. Sess. (1978).

The implementation of PURPA in the 1980s coincided with a troubled period in the industry that began with the oil embargoes of the 1970s and later with the growing costs of nuclear power plants that were under construction at the time. Environmental advocacy also came of age during this period in part to oppose the expansion of nuclear power. In reaction to these high costs and perceived environmental risks, states—following the lead of PURPA—began to consider alternative power suppliers that promised lower costs to consumers with reduced environmental impacts. Renewable energy resources became the focus of state energy policies and states such as California, New York, and Texas began programs promoting these technologies.

The Commission was responsible for certifying QFs and general implementation of PURPA. FERC’s final rules implementing Section 210 in 1980 provided guidelines to the states for setting the rates, terms and conditions for utility purchases from QFs. The guidelines included a requirement that the rates for purchases from QFs be based on each utility’s “full avoided costs.” This requirement was challenged by utilities but eventually upheld by the U.S. Supreme Court in API v. AEP Service Corp., 461 U.S. 402.

IV. COMMENTS OF INDUSTRIAL CONSUMERS

A. PURPA Has Not Been Repealed And Its Purposes Remain Vital.

In a troubling passage in the NOPR, FERC states: “Roughly 25 years after the enactment of PURPA, we do not believe that all of the exemptions from the FPA are still necessary to encourage the development of cogeneration and small power production facilities. Second we are concerned that the broad nature of the exemptions set forth in section 292.601 remove a large number of generation sales from any regulatory oversight.” Industrial Consumers caution FERC

not to intrude on the Congressional domain in terms of cutting back on PURPA exemptions. The statutory objective remains to “encourage” QF generation.

Under PURPA, utilities are required to purchase power from QFs and they are obligated to sell standby, back-up, and maintenance power to QFs on a non-discriminatory basis.

Congress recognized when it enacted PURPA in 1978 that QF power could not develop unless QFs were assured of buyers for their excess power, an ability to purchase back-up power, and a right to interconnect. Enactment of PURPA served twin aims of encouraging environmentally-friendly generation and increasing the development of alternative, independent power generation.

PURPA has not been repealed. Rather, Congress has enacted statutory amendments (§210(m)), which authorize FERC to lift purchase obligations if and only if a competitive market exists such that the QF is indifferent to the statute’s original purchase obligation.

Industrial Consumers submit that the need for independent generation is as great now as when PURPA was adopted. The Commission’s concerns regarding “resource adequacy” is testament to this fact. Competition will only become a reality – and market power be reduced – as adequate generation develops that is independent of transmission owners. Even in those regions that have an operating RTO, a few players still dominate the market and competition remains a work in progress. None of these markets has reached a stable end state with respect to its market design because the issue of resource adequacy and the availability of long-term firm transmission rights remain highly contested. Until such an end state is achieved, the solution must be continued encouragement of QFs and assurance that QFs can “put” their power to utilities until markets are truly competitive. The continued viability of industrial cogeneration is also important for sustaining a healthy manufacturing base in the US economy with its jobs and purchasing power.

Industrial Consumers urge that FERC interpret its mandate under the EPAct 2005 to continue to foster the development of desirable energy-efficient QF generation and scrupulously to determine whether any wholesale market is truly competitive before relieving utilities from QF purchase obligations.

FERC's Order 2006, providing standardized interconnection procedures (Docket RM02-12), was intended to increase energy supply, preserve grid reliability, and lower wholesale electricity costs for customers by increasing the number and types of generators in the electric market, including development of non-polluting alternative energy resources.³ Order 2006, the culmination of extensive proceedings, was a responsible action by FERC to increase the number and participation of generators in wholesale markets. Industrial Consumers fully supported this action. Order 2006 recognized the continued need for independent generation and the role that independent generation serves in assuring adequate power supply, reducing customer costs, and providing competition to vertically-integrated utilities.

Discrimination against QFs by utilities is not a historical artifact. As recently as June 6, 2005, FERC issued an enforcement order requiring an Iowa electric cooperative to provide simple net metering to an Iowa farmer with a small wind-energy system. Gregory Swecker, 111 FERC ¶61,365 (June 6, 2005) (FERC Docket No. EL05-92). "Requiring Midland to offer net metering to Mr. Swecker and other similarly situated QFs will ensure that a principal purpose of PURPA will be met, i.e., encouraging alternative sources of energy and reducing the nation's dependence on fossil fuels," FERC ruled. "Offering net metering to small wind-powered facilities, moreover, is consistent with the provisions of PURPA that ensure that utilities do not pay more than the incremental cost of power, while ensuring that wind-powered facilities are

³ FERC Press Release May 12, 2005, "Commission Issues Standard Rule For Small Generator Interconnection; Action Will Facilitate Needed Infrastructure Development," available at <http://www.ferc.gov/press-room/pr-current/05-12-05.aps> (last visited Aug. 30, 2005).

paid an avoided-cost rate for electricity sold from their QFs... .” FERC observed: “We cannot help but note that Midland has used the legal process to thwart efforts to compel it to comply with PURPA for seven years, with a long history of using every means at its disposal to avoid its obligation to purchase from Mr. Swecker’s small wind-powered QF.”

B. The Abuse Of “PURPA Machines” Is A Historical Artifact That Should Not Drive Current Policy.

PURPA did not require that utility purchases from QFs be under long-term power sales agreements. However, several states required utilities to offer long-term contracts for terms of 10 to 20 years. The most infamous examples were the contracts under New York’s Six-Cent Law and California’s Standard Offer 4 (“SO4”) contracts.⁴ The fixed payments reflected in those contracts were usually based on forecasts of increased oil and natural gas prices that ultimately proved to be wrong.⁵ These high avoided costs were the incentive for so-called “PURPA machines”—generators that maximized electricity production for sale to the utility but not thermally matched to legitimate useful heat utilization for dedicated commercial or industrial purposes. But PURPA machines were the exception rather than the rule. The high-priced SO4 contracts have long since expired and New York’s Six-Cent Law was repealed in 1992. Contracts that remained were treated as “stranded costs” and dealt with as such. The problem—to the extent it was problem—has run its course. There is no reason to expect any revival of PURPA machine development.⁶ What concerns Industrial Consumers is that the unwarranted fear of such a revival is instead a ploy for reinstating pre-PURPA obstacles to legitimate

⁴ Louise Guey-Lee, “Renewable Electricity Purchases: History and Recent Developments,” Renewable Energy 1998: Issues and Trends, Energy Information Administration, DOE/EIA-0628(98), March 1999 at 9.

⁵ Id. At the time of PURPA’s enactment, oil prices were rising and forecasts of \$100 or more a barrel were not uncommon.

⁶ States have modified their PURPA regulations to mitigate the potential ratepayer harm of created by the earlier rules. But states continue to encourage renewable energy resources with other policy tools such as renewable portfolio standards (RPS) or public benefit funds. Id. at 10.

cogeneration development in violation of federal law that still maintains that development be further encouraged.

C. FERC Should Preserve FPA Exemptions For Non-Utility QFs.

FERC proposes that QF sellers not subject to state avoided-cost regulation demonstrate that they comply with FERC's usual rules for selling power at market-based rates, i.e., do not have market power. FERC points out that under Section 1253(b) of EPAct 2005, the 50% limit on utility ownership does not apply. Industrial Consumers recommend that QFs with 50% utility ownership or more should be subject to the market power analysis and that QFs owned and controlled by independents not affiliated with transmission-owning utilities retain the exemption. The 1978 PURPA intended to exempt non-utility entities from treatment as utilities. Nothing has changed in the industry that would justify this additional regulatory burden on QFs that are independent of utilities.

A coordinate goal of the 1978 PURPA, in addition to encouraging energy efficiency – is to promote independent competition to vertically integrated IOUs. Congress mandated an intention to toughen specific aspects of PURPA, for example, to avoid “PURPA machine” abuses, and to encourage continued technological innovation.

Large, independent generation represents a pro-competitive force important to implementing FERC's FPA objectives of promoting competition in wholesale competition. FERC's suggestion that mini QFs below 5 MWs should not be subject to the same showing as other entities seeking to charge market-based rates is not enough. Competition by very small generators is inadequate to carry out the pro-competitive mandate of PURPA and of current FPA initiatives that recognize the importance of encouraging independent generation. FERC has applied its “Edgar” policy to assure that affiliated generators do not enjoy a “safety net” that

gives them an advantage over independents.⁷ (Orders 2003 and 2006, *supra*, implementing FERC's new interconnection policies for large and small generators respectively.)

D. QF Certification: KWh Output Should Be Sized To The Useful Heat Utilization Dedicated To A Commercial Or Industrial Purpose And The Facility's Overall Efficiency.

FERC is mandated to assure that power from new QFs is primarily directed to useful commercial or industrial purposes and meets overall efficiency criteria versus sales to utilities. FERC should carry out this mandate in a way that balances competing considerations: not to deprive bona fide larger QFs of PURPA protections, while assuring that generators do not seek QF status when they are in fact merchant generation. EPCRA 2005 requires that:

(i) the thermal energy output of a new qualifying cogeneration facility is used in a productive and beneficial manner; (ii) the electrical, thermal, and chemical output of the cogeneration facility is used fundamentally for industrial, commercial, or institutional purposes and is not intended fundamentally for sale to an electric utility, taking into account technological, efficiency, economic, and variable thermal energy requirements, as well as State laws applicable to sales of electric energy from a qualifying facility to its host facility; and (iii) continuing progress in the development of efficient electric energy generating technology.

FERC's NOPR is intended on the one hand to avoid "PURPA machines" and also on the other hand to disallow merchant generation from QF status.

Industrial Consumers as ratepayers are strong advocates of eliminating PURPA machine abuses. Nonetheless, Industrial Consumers urge FERC to adopt clear rules at the outset to assure that legitimate industrial cogeneration is not disabled from qualification as QFs merely because of their size. As long as the useful heat utilization is dedicated to a commercial or industrial purpose and overall efficiency criteria are met, the size of the nameplate rating of the generator should not matter.

⁷ Cinergy, 102 FERC, 61,128 (2003).

Two additional considerations are necessary when matching the useful heat utilization. First, the facility may lose a portion of the optimal useful heat utilization because there is no practical configuration that one could design such that the host would be an “exact” match and still achieve the economic efficiencies. Second, the commercial or industrial purpose may have a higher reliability requirement such that some degree of redundancy is necessary. These considerations could increase the kWh output without constituting a sham. It is a reflection of the on-site economics of the integrated manufacturing process.

E. Existing Facilities Are, By Definition, Not New QFs.

To avoid upsetting legitimate contractual expectations, Congress expressly grandfathered QF facilities in existence on the date of enactment. The statute provides (Section 210(n)(2)):

(2) Notwithstanding rule revisions under paragraph (1), the Commission's criteria for qualifying cogeneration facilities in effect prior to the date on which the Commission issues the final rule required by paragraph (1) shall continue to apply to any cogeneration facility that—

(A) was a qualifying cogeneration facility on the date of enactment of subsection (m) [enacted Aug. 8, 2005], or

(B) had filed with the Commission a notice of self-certification, self-recertification or an application for Commission certification under 18 CFR 292.207 prior to the date on which the Commission issues the final rule required by paragraph (1).

Industrial Consumers have some concern that utilities that are hostile to the competitive threat of on-site generation may advocate that any change in ownership may establish a new QF. Such a change would be unwarranted. First, the EPAct 2005 specifically preserves a distinction between existing and new “facilities” as measured by the landmark date of August 8, 2005. It would negate the statutory mandate were a change in ownership of a joint venture to jeopardize the facility’s ability to retain PURPA protections. Second, under existing FERC PURPA rules, a change in ownership of a joint venture does not establish a “new” QF. Although Industrial Consumers recognize that certain changes in status should be notified pursuant to 18 C.F.R.

292.207, as energy efficiency criteria must still be met and changes in ownership whereby transmission-owning utility interests exceed 50% should affect market power analysis, these changes in status do not strip QFs in existence on August 8, 2005 from their grandfathered status.

F. Industrial Consumers Commend FERC For Deciding To Set The Ground Rules For Section 210(m) Waiver Of Utility Purchase Obligations In A Generic Proceeding.

FERC states in the October 11, 2005 press release accompanying this NOPR that it will undertake a new rulemaking to implement Section 210(m) – allowing utilities to seek relief from mandatory QF purchase requirements where they meet statutory preconditions. Industrial Consumers commend FERC for this action. The outcome of this rulemaking is important. FERC should not act precipitously on utility – specific filings such as the Alliant and MDU petitions.⁸ Rather than develop its policies ad hoc based on the first utility-specific filings that are submitted, it will lead to a better policy result if FERC considers the factual and legal showings that must be made to obtain waivers under Section 210(m) in the context of generic proceedings. A generic proceeding will allow utilities, QFs, consumers and other stakeholders to address the definition of the parameters for determining competitive markets. FERC will begin to develop a record as to the state of the markets in all regions of the country, including but not limited to areas with RTOs.

V. DESCRIPTION OF INDUSTRIAL CONSUMERS

ELCON is an association of industrial consumers of electricity organized to promote the development of coordinated and rational federal and state policies that will assure an adequate, reliable, and efficient electricity supply for all users at competitive rates. ELCON member companies produce a wide range of products from virtually every segment of the manufacturing

⁸ Respectively, Dockets EL05-143-000 and EL05-152-000.

community. The member companies of ELCON consume approximately five percent of all electricity in the United States.

The American Iron and Steel Institute (AISI) is the principal trade association of the North American steel industry. Its member companies account for about seventy percent of the new steel production in the United States. The steel industry is one of the most energy-intensive sectors in the United States; the cost of electricity may constitute as much as twenty percent of the manufacturing cost of a steel mill product.

VI. NOTICES AND COMMUNICATIONS

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