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Public Utility Regulatory Policies Act of 1978: A Fact Sheet

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INTRODUCTION

The Public Utility Regulatory Policies Act of 1978 (PURPA, P.L. 95-617) was, in part, intended to augment electric utility generation with more efficiently produced electricity and to provide equitable rates to consumers. Under PURPA, utilities are required to buy all power produced by a class of nonutility electric generators called qualifying facilities (QFs). In 1990, QFs supplied approximately six percent of electricity in the United States.¹ QFs are exempt from the Public Utilities Holding Company Act of 1935 (PUHCA) and therefore would not be affected by current proposals to reform PUHCA.

QUALIFYING FACILITIES

Two types of generators can be certified as a qualifying facility: a small power producer and a cogenerator. About half of all new cogenerators and small power producers self-certify their facilities with the Federal Energy Regulatory Commission (FERC) for a \$50 filing fee. However, FERC has the authority to determine whether a generator is a QF. If there is any doubt about a generator's qualifying status, FERC reviews the application. Small power producers are charged \$9,100 and cogenerators are charged \$10,540 for application review.

Small Power Producer. A qualifying small power production facility is defined in the Federal Power Act as an electric generator that meets certain FERC rules including requirements respecting fuel use, fuel efficiency and reliability (16 U.S.C. 791a-825r). Size limitations for small power production facilities using solar, wind, waste, or geothermal energy have been removed temporarily.² FERC also sets an ownership requirement for QFs. A qualifying small power production facility must be owned by a person that is not primarily

¹ Edison Electric Institute. 1990 Capacity and Generation of Non-utility Sources of Energy. December 1991. p. 24.

² P.L. 101-575. In order to be considered QFs with no size limitations, these facilities must either apply to FERC for certification as a qualifying small power producer or self-certify their facility as a QF prior to December 31, 1994. In addition, construction of the facility must begin prior to December 31, 1999.



engaged in the generation and sale of electricity. However, the owner may sell power exclusively from small power producers and cogenerators.

Cogenerator. Cogeneration is the sequential production of both electric energy and steam, or other forms of useful energy (such as heat), which are used for industrial, commercial, heating, or cooling purposes. A typical cogeneration facility burns a primary fuel (e.g., natural gas) to create steam that drives a mechanical process and also generates electricity. Cogeneration was introduced to the United States in the latter part of the 19th century, but has only recently emerged as a widely used source of electricity. To be considered a QF, a cogenerator must meet FERC ownership and operational requirements that are similar to those required of small power producers.

RATES

Departing from traditional utility rate regulation, PURPA shifted the price basis for electricity from the seller's cost to the purchaser's cost. Under PURPA, the local utility must purchase all power produced by QFs in their service area at "avoided cost." FERC adopted rules under PURPA to define avoided cost: the likely costs for both energy and facilities that would have been incurred by the purchasing utility if that utility had to provide its own generating capacity.

PURPA raised some doubt as to whether the avoided cost concept was consistent with constitutional just compensation requirements, but these Fifth Amendment concerns were obviated in 1986.³ The rules requiring electric utilities to pay cogenerators and small power producers avoided cost were found not to take property without just compensation in instances where the electric utility could charge ratepayers avoided cost and earn a profit.⁴

State rate regulators have wide latitude in establishing the procedure to assign avoided costs. Initially, avoided costs were frequently set too high, resulting in more QF power than host utilities could reliably transmit or use. To avoid this problem, many States are now using bidding systems to determine avoided costs.⁵ In these systems, non-utility generators bid to provide the cheapest power to utilities. These bidding systems are intended to substitute for rate-making approvals of power purchase transactions, but participating State utility commissions still determine ground rules for these auctions and provide oversight. Bidding results in a more competitively based price, putting the emphasis back onto the seller's costs rather than the purchaser's avoided cost.

³ The Fifth Amendment assures that private property can not be taken for public use without just compensation.

⁴ *Kansas City Power & Light Co. v. State Corporation Commission*, 238 Kan. 842 (1986), *appeal dismissed* 107 S.Ct. 41 (1986).

⁵ These States include: CA, CO, DE, FL, HI, IN, MD, MA, ME, NV, NH, NJ, NY, OH, TX, VA, VT, WA.