

**A WHITE PAPER ON THE ENERGY POLICY ACT OF 1992:
AN OVERVIEW FOR STATE COMMISSIONS
OF NEW PURPA STATUTORY STANDARDS**

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PREFACE

On October 24, 1992, Congress enacted and the President signed the Energy Policy Act. State public service commissions play a key role in implementing the Act, with mandatory immediate or short-term assignments as well as longer-term concerns. In response, The National Regulatory Research Institute has undertaken an NRRI Board-approved project to assist the state commissions. This "white paper" is the first piece in that effort. It provides state commissions with an overview of and some insights about the new PURPA standards that they must consider. Later NRRI reports will address the Energy Policy Act more fully as well as the longer-term concerns that it raises.

Douglas N. Jones
Director
April 1993

Introduction and Overview

The Energy Policy Act of 1992 (P.L. 102-486) (EPACT) was passed by Congress on October 8, 1992 and signed into law by President Bush on October 24, 1992. EPACT comprises a wide variety of energy policies, many of which affect state public service commissions and their regulated utilities. Some of these policies, in turn, are contained in key provisions that affect state public service commissions directly. These provisions require the state commissions to consider whether adoption of certain standards would carry out the purposes of the Public Utility Regulatory Policies Act of 1978 (PURPA). This white paper summarizes those compliance provisions that require immediate or short-term attention by state commissions.

A later NRRI report will discuss, among other things, the likely restructuring of the electric industry resulting from greater competition in the wholesale power market. This greater competition is encouraged by the creation of a new class of generators, exempt wholesale generators (EWGs), and more open transmission access. EPACT exempts EWGs from regulation under the Public Utilities Holding Company Act of 1935 (PUHCA). EWGs can generate electricity for sale at wholesale and request the Federal Energy Regulatory Commission (FERC) to order a utility to transmit its power at wholesale to another utility. The combination of EWGs and more open transmission access will lead to industry restructuring with more open and competitive wholesale markets for purchased power. The reader should keep in mind these potential changes when considering the adoption or rejection of the new PURPA standards enacted in EPACT.

This paper has five main sections and an appendix. The first section provides an overview of the role of PURPA sections 111 and 303 and discusses how an understanding of these sections is necessary before going further. Five individual subsections of the first section discuss: (1) PURPA 111, the purposes of PURPA, what is a PURPA consideration, and what is a PURPA determination; (2) procedural requirements on how to consider and make PURPA determinations; (3) results of an NRRI survey regarding state activities on EPACT section 712; (4) PURPA interventions, deadlines, and grandfathering; and (5) the role of PURPA section 303. The paper's

second and third sections introduce the new PURPA standards from EPACT section 111 and 115, the electric and gas efficiency standards.

In the critical fourth section, the EPACT section 712 standard on the purchase of long-term wholesale power is discussed. This is the standard requiring state regulator's most immediate attention. The section has three subsections. The first covers the section 712 cost of capital evaluation, and the second concerns the section 712 leveraged capital evaluation. The third subsection covers two interrelated section 712 evaluations: the contract preapproval issue and the assurance of fuel evaluations.

The paper concludes with a summary table of concerns about EPACT section 712. Finally, the paper ends with selected provisions of PURPA as amended, and a time line of EPACT deadlines for section 712, section 111, and section 115 considerations and determinations.

The Role of PURPA Sections 111 and 303

PURPA Section 111: A Consideration of Purposes and a Determination of Whether or Not to Adopt

The EPACT sections that state public service commissions will have to address during the next few years include amendments to sections 111 and 303 of the PURPA. Section 111 of PURPA requires each state public service commission to consider statutory standards in terms of carrying out the purposes of PURPA Title I and to determine whether or not the standards are appropriate to adopt. These purposes, spelled out in PURPA section 101, are to encourage: (1) conservation of energy supplied by electric utilities, (2) optimization of the efficient use of facilities and resources by electric utilities,¹ and (3) equitable rates to electric consumers. The purposes of Title I supplement otherwise applicable state law. Further, state commissions may determine that it is not appropriate to implement a statutory standard pursuant to their authority

¹ A clear restatement of the second PURPA purpose, "optimization of the efficient use of facilities and resources by electric utilities," is "making more efficient use of the utilities' facilities and resources."

under state law. For example, a commission may reject a standard if acceptance would be contrary to state law. State commissions also may reject a standard by determining that the statutory standard would be inappropriate to carry out the three purposes of Title I.

In addition, state commissions may determine it is appropriate to partially implement or phase-in implementation of the standards when immediate full implementation would impose a hardship on the ratepayers. Further, section 117 of PURPA makes it clear that state commissions are free to adopt, under state law, standards or rules which differ from the PURPA section 111 standards.

Significantly, nothing in Title I of PURPA may authorize or require recovery of revenues or a rate of return that is in excess of (or less than) revenues or rate of return determined to be lawful exclusively under state law. Consequently, the principal federal concern is with rate structure and rate design, rather than the overall revenue requirement or rate of return.

Section 111: Procedural Requirements

For a state commission to consider and make a determination about a PURPA section 111 standard, it must provide a public notice and conduct a hearing. The determination of whether the standard is appropriate for the three purposes of the Title must be in writing, based on the findings of the determination and the evidence presented at the hearing, and made available to the public.

The requirement of a hearing does not necessarily imply an exhaustive rate-case-style adjudicatory hearing. Rather, the procedures for the hearing shall be established at the discretion of the state commissions, allowing them some flexibility to pattern their procedures in a manner that is both efficient and effective. Such a broad reading of state procedural discretion is consistent with the underlying goals of promoting efficiency and equity. State commissions may use innovative administrative procedures as long as there is a meaningful opportunity to be heard for all parties at some point in the proceeding. Examples of these procedures can be found in the NRRI's report *Administrative Procedures for Proactive Regulation*.² Although the legislative history of PURPA section 111 clearly states that the rights and privileges of all parties including intervenors will be the same as those in rate cases, state commissions may use expedited procedures, particularly in the case of EPACT section 712, where commissions have a short compliance deadline. It is certainly within the power of the state commission to require the parties to submit written direct and rebuttal testimony, with an abbreviated hearing for cross-examination. Such a proceeding, commonly known as a paper hearing or an abbreviated hearing, could limit the time each party has to cross-examine witnesses.³ Other options would be for a state commission to engage in a problem-solving workshop (a collaborative process), an open technical conference, or a negotiated rulemaking. The key to complying with the statute is to provide adequate public notice to the parties and to provide them with some opportunity to be heard, with the right to challenge the accuracy or veracity of the evidence presented by opposing parties. Abbreviated cross-examination or written rebuttal testimony can both serve this purpose adequately.

NRRI Survey

² Robert E. Burns, *Administrative Procedures for Proactive Regulation* (Columbus, Ohio: The National Regulatory Research Institute, 1988).

³ Paper hearings similar to those described here are planned for the EPACT section 712 consideration by the Missouri Public Service Commission and the Pennsylvania Public Utilities Commission per a telephone conversation with Charles Gray, Associate General Counsel, The National Association of Regulatory Utility Commissioners, February 1993.

In February and March 1993, the NRRI sent a survey concerning implementation of section 712 of EPACT to all state public service commissions. The survey addressed commission plans to open a docket on section 712 and the process chosen to reach final determinations. The processes specifically queried were informal rulemaking, negotiated rulemaking, paper hearings, adjudicatory hearings, and alternative dispute resolution. Table 1 lists the results from the thirty-eight responding state commissions.

Almost two-thirds of state service commission respondents had either issued a docket on section 712 (ten states) or planned to do so shortly (fourteen states). Fifteen states chose informal rulemaking, eight states chose adjudicatory hearings, and five states chose paper hearings as the preferred process to reach a determination. No state service commission selected negotiated rulemaking or alternative dispute resolution procedures to reach determinations.

More on Section 111: Intervention, Deadlines, and Grandfathering

PURPA sections 121 and 122 are quite specific in requiring that the Secretary of Energy, any affected electric utility, or any electric consumer of an affected utility may intervene as of right and participate in any appropriate regulatory proceeding that involves the consideration of a PURPA section 111 standard. Any intervenor or participant will have access by means of discovery to relevant information available to other parties. The statute also provides for utility compensation of consumer intervenors that substantially contribute to the approval in whole or in part of the position advocated by the consumer. The state commission, however, can limit compensation to those with significant financial hardship. Alternatively, state commissions can require that persons with the same or similar interests have a common attorney. No compensation from utilities is required to consumers who have or represent an interest that would have otherwise been adequately represented and whose representation resulted in a fair determination, and when a state commission otherwise provides compensation.

TABLE 1--Continued

States	MT	NV	NH	NM	NY	NC	ND	OH	OK	OR	RI	SC	SD	TN	VT	VA	WA	WV	WI
Docket on Section 712	P	N	P	P	P	Y	Y	N	N	P	P	P	P	N	P	Y	N	N	N
Informal Rulemaking	P		N	P	P		P			P	P	P	P		N	Y			
Negotiated Rulemaking			N	N	N		N			N	N	N	N		N				
Collaborative Process				N	Y		N			N	P		N		N				
Paper Hearing				N	Y		N			N	N	N	N		N				
Adjudicatory Hearing				N	N	Y	Y			Y	N		Y						

Source: 1993 NRRI survey.

Note 1: Y=Yes; N-No; P=Planned

Note 2: The following PSCs did not respond: AK, CT, DC, GA, HI, IL, MN, NE, NJ, PA, TX, WY.

The state commissions are expected to hold hearings within the time limits specified. The time limitation for consideration of EPACT section 712 is very short, requiring a hearing to be held, and consideration and determination to be made by the state commission not later than one year from the enactment of EPACT (October 23, 1993). As will be shown below, the time limits for other EPACT standards are more generous. These are summarized in the time line found at the end of the Appendix.

Further, PURPA section 124 makes clear that prior and pending proceedings begun and actions taken on a standard before the enactment of EPACT can be treated as complying with the consideration and determination requirements of PURPA section 111, if the proceedings or actions substantially conform with the requirements of section 111. Congress recognized that many state commissions have already addressed one or more of the standards before EPACT's enactment. A prior consideration and determination of a standard need not have necessarily had the full right of participation and intervention required by PURPA section 121. If the prior proceeding substantially conformed with the requirements of section 111, the state's consideration and determination of the standard are grandfathered. For a prior proceeding to be in substantial compliance, a state commission must have done a utility-by-utility analysis of the appropriateness of the standards for carrying out the three purposes of Title I--keeping in mind, of course, that no one could precisely follow the exact consideration required because the standards had not been enacted.

The grandfathering provision of PURPA section 124 applies only to the efficiency standards of EPACT Title I. The EPACT section 712 standard specifically states that the grandfathering provision of section 124 does not apply. Even if a state commission had in a prior proceeding conducted a consideration and determination of the EPACT section 712 standard that was in substantial compliance, state commissions are obligated to hold a new hearing to consider and determine the appropriateness of the standard. Again, the requirement is that this be done within a one year timeframe, that is no later than October 23, 1993.

The legislative history of PURPA 111 makes clear that a utility-by-utility consideration and determination of the standards are required. However, proceedings need not be in a rate-case context. Although the intent is to examine the standards on a utility-by-utility basis with a

separate determination for each utility for each standard, state commissions are permitted to hold generic proceedings.

The Role of Section 303

In the case of natural gas, PURPA Title III contains some language that roughly parallels Title I. However, the purposes of Title III against which the standards are to be considered are: (1) the conservation of energy supplied by gas utilities, (2) optimization of the efficient use of facilities and resources by gas utility systems,⁴ and (3) equitable rates to natural gas consumers. Gas utility operations associated with sales of gas for resale (wholesale sales) are excluded from the Title. A gas utility is any local distribution company or any person, or state or federal agency engaged in the sale of natural gas to any ultimate consumer. (Given the rise of direct sales from the wellhead to ultimate gas consumers, if read literally, this Title would appear to apply to certain gas producers. It is doubtful that this was the intent of Congress.) Thus a state commission is required to consider and to determine whether PURPA section 303 standards are appropriate to carry out the purposes noted above and are consistent with state law. Title III also has parallel provisions concerning grandfathering of prior and pending proceedings. Finally, under PURPA section 308 state commissions are allowed to adopt, under state law, standards or rules that differ from those in Title III.

EPACT Section 111: Efficiency Standards

There are three efficiency standards in Title I of EPACT that are amendments to PURPA section 111. These standards are found in EPACT section 111. The first standard requires consideration of integrated resource planning (IRP) that compares supply and demand-side options on a systematic and comparable basis (PURPA section 111(d)(7)). The second standard requires consideration of cost recovery for energy conservation, demand-side management

⁴ A restatement of the second purpose is to use the gas utility systems' facilities and resources more efficiently.

(DSM), and energy efficiency programs and measures that are at least as profitable, given appropriate consideration to the resulting lost sales, as investments in generation, transmission, and distribution (PURPA section 111(d)(8)). The third standard requires consideration of rates that provide incentives for investments in cost-effective improvements in the energy efficiency of power generation, transmission, and distribution (PURPA section 111(d)(9)). Again, the state commission is to consider each of these standards in light of carrying out the purposes of PURPA Title I.

If a state commission does implement either of the first two EPACT efficiency standards (either PURPA section 111(d)(7) or (8)), the state commission is also required to consider the impact that the standard would have on small businesses engaged in the design, sale, supply, installation, or servicing of energy conservation, energy efficiency, or other DSM measures, and to implement the standard in a way to assure that utility actions would not provide these utilities with unfair competitive advantages over such small businesses.

The state commissions are required to commence consideration or set a hearing date for consideration of these standards not later than two years after the enactment of EPACT, not later than October 23, 1994. The state commissions are required to complete the consideration and make a determination of the appropriateness of the standards no later than three years after the enactment of EPACT, not later than October 23, 1995. If a state commission has not complied with these deadlines, the state commission will undertake consideration and determination of the efficiency standard(s) in the first rate proceeding to commence after October 23, 1995.

EPACT Section 115: Efficiency Standards

EPACT section 115 amends PURPA sections 302 and 303 by adding two new standards for consideration under PURPA Title III. These two standards include (1) the use of IRP by each gas utility (PURPA section 303(b)(3)), and (2) the encouragement of investments in conservation and DSM mechanisms (PURPA section 303(b)(4)). The IRP standard requires that the objective of a plan is to provide customers with adequate and reliable utility service at the lowest system cost. Such plans or filings are to be updated on a regular basis, provide an opportunity for public

participation and comment, provide methods of validating predicted performance of DSM measures, and contain a requirement that the plan be implemented after approval of the state commission. The investment in conservation and DSM standard requires that rates are such that a gas utility's prudent investment in and expenditures for conservation and DSM are at least as profitable as a utility's prudent investment in and expenditures for the acquisition of sales or construction of facilities. Lost revenues from reduced sales are taken into account as a part of the standard.

PURPA section 302 is amended to make clear that, in the case of a gas utility, IRP means planning by the use of any standard, regulation, practice, or policy that undertakes the systematic comparison between DSM measures and the supply of gas by a gas utility to minimize the life-cycle costs of providing adequate and reliable utility services. IRP will take into account the diversity of features necessary for system operation, including reliability, dispatchability, and other factors of risk. Demand and supply to gas consumers will be treated on a consistent and integrated basis.

Under PURPA section 303 as amended, each state commission is required to provide public notice and conduct a hearing on the appropriateness of the standards for carrying out the purposes of Title III, not later than October 23, 1994.⁵ The commissions are also required to determine that the standard is consistent with state law, and is otherwise appropriate. Under PURPA section 303(c) as amended, each state commission will make its determination on whether or not to adopt each standard within two years of the enactment of EPACT, not later than October 23, 1994.

If a state commission does implement either of the two EPACT gas efficiency standards (either PURPA section 303(b)(3) or (4)), the state commission is also required to consider the impact that the standard would have on small businesses engaged in the design, sale, supply, installation, or servicing of energy conservation, energy efficiency, or other demand-side management measure, and implement the standard in a way so as to assure that utility actions

⁵ The purposes of Title III are similar to the purposes of PURPA Title I. They are (1) conservation of energy supplied by gas utilities, (2) optimization of the efficient use of facilities and resources by gas utility systems, and (3) equitable rates to natural gas consumers.

would not provide such utilities with unfair competitive advantages over such small businesses.

EPACT Section 712: Standard on the Purchase of Long-Term Wholesale Power

EPACT section 712 is the new PURPA standard requiring the most immediate attention by state commissions. According to its provisions, state commissions are required to consider and make a determination on the appropriateness of the standard to carry out the purposes of Title I not later than one year after EPACT's enactment. Thus, state commissions have until October 23, 1993 to complete their consideration and determination of whether to adopt, in whole or in part, or reject the section 712 standard. Unlike the other EPACT standards, no grandfathering of proceedings commenced prior to the enactment of EPACT is allowed.

When approaching EPACT section 712, it is important to remember that it is an amendment to PURPA section 111 and is therefore a PURPA section 111 standard. In spite of the early deadline and the "no grandfathering" provision, it is a PURPA standard; as such, the standard, in its four parts (each requiring a general evaluation), is to be considered against the purposes of PURPA Title I. Determinations of the appropriateness of the standard, in whole or in part, nevertheless, should be on a utility-by-utility basis. As discussed earlier, a generic, paper hearing would probably be acceptable.

If adopted, the section 712 standard would require a state commission to perform four general evaluations when considering the purchase of long-term purchased power to fulfill demand.⁶ As a part of their IRP or other future planning process, most, if not all, state commissions require or allow their utilities to consider the purchase of long-term wholesale power to meet demand (as opposed to restricting wholesale power purchases to short-term economy purchases). It would probably be imprudent for a utility not to consider the long-term wholesale

⁶ The standard is limited and only requires a state commission to perform the four evaluations to the extent the state commission requires or allows its jurisdictional utilities to consider the purchase of long-term wholesale power supplies as a means of meeting electric demand. In a state where the commission does not require or allow its utilities to consider the purchase of long-term wholesale power as a mean of meeting electric demand, the standard would have no effect. However, every state commission allows purchased power to some extent.

purchased-power option. (Therefore, each state commission would probably need to consider and determine the appropriateness of each of the four parts of the section 712 standard.)

Section 712: Cost of Capital Evaluation

The first of these section 712 general evaluations is the potential for increases or decreases in the utility's cost of capital and any resulting increases or decrease in retail rates that may result from purchases of long-term wholesale power supplies in lieu of the construction of the utility's own new generation facilities. To comply with PURPA section 111, state commissions are not required to do such a general evaluation. Rather, the issue for state commissions under PURPA section 111 is whether conducting such a general evaluation before long-term wholesale power purchases would carry out the purposes of PURPA Title I.⁷

This part of the section 712 standard as currently phrased would not lead to conservation of energy supplied by electric utilities. Unless the question is properly rephrased, it is not clear that a general evaluation of the sort suggested by the standard would lead to optimally efficient use of facilities and resources by electric utilities or equitable rates to their customers. To put the question properly, would the utility's cost of capital increase more if the utility purchased power or if it built the plant itself? Even so, the correct time for such an evaluation would be during an IRP process or a competitive bidding process.

Bond-rating services have recently downgraded the bonds of electric utilities for long-term wholesale purchases. It is the opinion of these bond-rating services that long-term power purchases are the equivalent of debt. There is an issue, therefore, of whether long-term purchased power leads to the lowest cost electricity. Indeed, if all other things remained the same, there should be a case-by-case evaluation of whether the purchase of long-term wholesale power would lead to decreases in retail rates or whether both utility and consumer are better off allowing the construction by the utility of new generation facilities. Yet, this evaluation may be currently done

⁷ It would encourage (1) conservation of energy supplied by electric utilities, (2) optimization of the efficient use of electric utility facilities and resources, and (3) equity of rates to electric consumers

in the context of competitive bidding for new power sources or within the purview of IRP. Most states conducting competitive bidding currently look at the retail-rate effect of a utility purchasing long-term wholesale power as opposed to building its own facility. This is currently done by comparing the utility's own bid (or its stated avoided cost) against other bids.⁸ The actions of bond raters in downgrading a utility's bond rating and hence increasing the utility's cost of capital, however, add an interesting wrinkle to the analysis.

The reason that bond-rating companies are downgrading utilities that engage in long-term wholesale power purchases is twofold. First, it is felt that the utility is standing in the place of the seller of long-term wholesale power and that the utility has assumed risks that are equivalent to debt. This is only the case when the utility does a poor job of contracting. Various means by which utilities can protect themselves and their ratepayers from risks associated with long-term wholesale power purchases include secured and unsecured liens, the right to enter and take possession and control, the right to enter and inspect, specific maintenance standards, specific operation standards, a liquidated damages clause, a performance security bond, and defined force majeure provisions.⁹ Others might include an "evergreen" or a market-out provision. Given past experiences, take-or-pay contract provisions shift too great a risk to utilities and hence to ratepayers and are probably imprudent. Also, it is typical that the provider of long-term wholesale power is only paid for power delivered. When an electric utility builds its own plant, the prudently invested expenditures in that plant go into rate base so long as the plant is used and useful. There are many occasions where a utility earns a return on its plants even though they might be on standby or unavailable. It may often be more equitable for retail ratepayers to pay for power received than for unavailable plant.

Ironically, if a utility builds higher-cost plants than would be available through the wholesale purchased power market, it may burden the utility's competitive profile at a time when more open wholesale markets and transmission access might jeopardize its ability to sell its load.

⁸ See for example, Kenneth Rose, Robert E. Burns, and Mark Eifert, *Implementing A Competitive Bidding Program for Electric Power Supply* (Columbus, Ohio: The National Regulatory Research Institute, 1991).

⁹ Ibid.

Logically, this option should also lead to a credit downgrading.

This leads to the second reason for downgrading a utility's bonds. Although a utility earns a return on its own investment, it does not (in most states) have an opportunity to earn a reward for efficiently procuring a portfolio of purchased power contracts. (Presumably, long-term wholesale purchased power would be a part of such a portfolio.) What is needed instead of a cumbersome case-by-case general evaluation standard is a new look at the role that fuel adjustment clauses play in a more competitive and open wholesale power market.

The NRRI undertook such a study in 1991, anticipating the passage of legislation such as EPACT that would be designed to open up wholesale power markets. A recent NRRI report¹⁰ concludes that a performance-based purchased power mechanism is needed to reward utilities for reacting exceptionally to the market and minimizing the cost of adequate and reliable power. The authors suggest the use of a benchmark set at an historical fixed-weight representing a utility's purchased power contracts portfolio. This fixed-weight is then indexed to purchased power prices of component types of contracts. Such a mechanism would reward utilities for making good purchased power choices, helping to level out the playing field between purchased power and power from the utility's own plant. Unfortunately, wholesale power markets need to be better developed and organized before the suggested performance-based mechanism would be feasible. However, other similar approaches might be currently possible and might lead to a more efficient use of facilities and resources by all electric utilities, conserve energy supplied by electric utilities, and be equitable to ratepayers.

Section 712: Leveraged Capital Evaluation

The second of the four general evaluations that state commissions would be required to undertake if the section 712 standard is adopted is whether the use by exempt wholesale generators (EWGs), defined in EPACT Title VII, Subtitle A, of highly leveraged capital structures

¹⁰ Robert E. Burns, Mark Eifert, and Peter Nagler, *Current PGA and FAC Practices: Implications for Ratemaking in Competitive Markets* (Columbus, Ohio: The National Regulatory Research Institute, 1991).

that employ greater proportions of debt than found in the capital structures of utilities, threatens reliability or provides an unfair advantage for EWGs over utilities. Again, state commissions are merely required to consider whether the 712 standard would carry out the purposes of Title I. It is not necessary to complete each general evaluation.

First, it is difficult to see how conducting this general evaluation would lead to conservation of energy supplied by electric utilities. Whether EWGs have an unfair advantage over utilities is irrelevant to conservation of energy supplied by electric utilities. Reliability is a concern, but only if a lack of reliability causes the utility to compensate for the EWG's lack of reliability by building to add to its reserves or purchasing other sources of wholesale power at higher prices. Similarly, fairness is irrelevant to the efficient use of utility facilities and resources, except to the extent that fairness results in inefficiency. Here too, reliability concerns could lead to inefficient use of facilities and resources. So long as purchasing long-term wholesale power from EWGs results in adequate and reliable service at the lowest possible cost, then there should not be a concern about equitable rates. Again, the concern seems to be reliability.

Concerning reliability, qualifying facilities (QFs) and independent power producers (IPPs) have thus far been as reliable as the utilities' own plants. As stated earlier for the first general evaluation, however, there are various contractual means by which a utility can help further to assure reliability. These contractual provisions should provide some assurance in the event of an unreliable EWG that the utility will be either compensated through a substantial performance bond for power purchases in lieu of those from the EWG or the utility could obtain the legal right to operate the facility.

Regarding whether EWGs have an unfair advantage over a utility, fairness to the utility is irrelevant for purposes of considering whether the section 712 standard is appropriate for carrying out the purposes of PURPA Title I. The Title I purposes encompass conservation, optimization of utility efficiency, and ratepayer equity (meaning equity and fairness to ratepayers, not fairness to the utility.) Nonetheless, sound regulatory principles as enforced by state commissions have always assured fairness, preserving the public interest by balancing the interests of ratepayers and utilities. Although it may be irrelevant for the purposes of Title I, state commissions may nevertheless choose to address in a generic fashion whether the greater reliance on debt in an

EWG's capital structure is unfair to utilities. In anticipation of the passage of EPACT, the NRRI addressed this topic in a recent NRRI report.¹¹ The utility argument that EWGs have an unfair advantage due to their capital structure can be succinctly stated: the cost of capital for an EWG is lower than the cost of capital for a utility because the regulatory process limits the firm in its ability to finance the assets of the firm with debt capital whereas the EWG has no such limit. A typical investor-owned utility is limited to a debt capacity of 50 percent, while in the unregulated market EWGs (currently QFs and nonutility generators (NUGs)) are often financed with higher levels of debt. Since debt financing is generally less costly than equity financing, the common belief is that a higher proportion of debt gives the EWG an inherent advantage with a lower cost of capital. Although real, the advantage is said to be unfair since regulators set the utility's debt limits, whereas EWGs have no such constraints. Therefore, it is "logically" concluded that EWGs have an unfair advantage and for lack of a "level playing field," more and more new capacity will be built by EWGs--not because of superior performance but because of a quirk in the regulatory process.

The above argument contains a fundamental flaw. There are limits to debt financing. The result, known as the Modigliani and Miller Propositions (M&M), states: assuming perfect capital markets, the value of a firm is a function of the risk-return parameters of the assets of the firm and the cost of capital is constant for all capital structures because the cost of equity will rise with greater debt to exactly offset the cost reducing properties of lower cost debt. Thus, financial theory tells us that EWGs have no cost advantage over utilities because of their capital structure. However, financial theory needs a "real world" test to check its assumptions. The M&M Propositions assume a perfect capital market where personal debt can be substituted for corporate debt at the same rate of interest and where assets with equal risk-return parameters will have equal prices. While we know that there are no perfect markets, any capital market imperfections are probably so small as to have a negligible effect on the firms' cost of capital. However, taxes and tax deductibility of interest payments affect the optimal amount of debt for a firm. The cost

¹¹ Kenneth Costello, Edward H. Jennings, and Timothy Viezer, *Implications of a New PUHCA for the Electric Industry and Regulators* (Columbus, Ohio: The National Regulatory Research Institute, 1992), appendix.

of capital in the capital structure of a firm does not constantly decline as the debt-equity ratio increases as naively inferred in the section 712 standard.¹² Nor is it constant as suggested by the nontax M&M Proposition. Rather, the cost of debt is saucer-shaped: first, with an initial decline because of the tax

¹² Section 712 seems to assume that as the debt-equity ratio increases the EWG would have both a lower cost of capital and lower reliability.

deductibility of interest payments; then, a flattening-out where the value of tax deductibility of interest payments is offset by the shift of business risk to the debt securities of the firm and the probability of financial distress; and finally, with an increase in these factors they ultimately overwhelm the value of tax-deductibility and create an increasing cost of capital. Under these conditions, it is unlikely that an EWG will have an "unfair" advantage over a utility because of its capital structure.

Consequently, there are two possible sources for differences in cost of capital between EWGs and investor-owned utilities. First, it might be that the investor-owned utility's capital structure is not optimal. In that case, regulators should not expend their efforts on trying to regulate the allowed capital structure of the EWG as a second-best response as EPACT section 712(10)(C) empowers them to do if the regulators find that such action would be in the public interest as a result of their general evaluations. Such regulation avoids the underlying problem and would only by sheer chance be in the public interest. Instead, regulators should consider either deregulating the capital structure of their investor-owned utilities or increasing the amount of debt allowed in the investor-owned utility's capital structure. In other words, if there is a problem with the capital structure of the investor-owned utilities, then its capital structure should be optimized so that the cost of capital is at a minimum. This should be done, with or without potential competition from EWGs.

However, it seems more likely that capital structures are neutral between EWGs and utilities and therefore EWGs are not unfairly advantaged by the existence of debt limits on investor-owned utilities. Instead, an EWG's lower cost of capital may be the result of "fair" advantages related to operating efficiencies, managerial efficiencies, operation in a less risky or more lucrative wholesale power market, more modern physical plant, and other operating factors. These factors are not constant between EWGs and utilities; they are likely to have a profound effect on an EWG's cost of capital. In such cases, the lower cost of capital is not unfair.

Section 712: Contract Preapproval and Assurance of Fuel Evaluations

The next two general evaluations are interrelated. The first would require the state commission¹³ to evaluate whether to implement procedures for the advanced approval or disapproval of particular long-term wholesale power supply purchases. In other words, the standard, if adopted, would require evaluation of a preapproval mechanism for particular long-term wholesale power supplies. The second general evaluation presumes that there is preapproval of particular long-term wholesale power purchases. It then calls for an evaluation of whether to require as a condition for preapproval of purchased power that there be reasonable assurances of fuel supply adequacy.

Does this part of the section 712 standard carry out the purposes of Title I? It is at least arguable that preapproval of particular long-term wholesale power purchases would lead to conservation of energy supplied by the jurisdictional electric utility because the reduction of so called "regulatory risk" that would accompany such a preapproval might tend to make a utility more willing to enter into particular long-term wholesale contracts with nonutilities, thus "conserving utility energy." Similarly, an argument might be made that determining whether to require that there be a reasonable assurance of fuel supply adequacy be a prior condition for preapproval of a power purchase. This can lead to conservation of energy supplied by electric utilities, again because it might encourage use of nonutility power. However, in a more open and competitive wholesale market it is not clear that these long-term wholesale contracts would necessarily be with EWGs or other QFs or NUGs. The contract might be with another utility that is simply

¹³ Again, the state commission, to the extent that it considers or requires long-term wholesale power supplies for meeting electric demand, would be required to evaluate whether to implement these procedures.

more efficient. In that case, there would be no conservation of energy supplied by electric utilities.

Greater use of purchased power which might result from a more open and competitive wholesale power market is probably desirable and might very well lead to more efficient use of electric utility facilities and resources. It is likely, however, that measures such as advanced approval or preapproval of particular transactions might unduly encourage a utility to enter into long-term wholesale power supply purchases. In a more open and competitive wholesale power market, there are likely to be a variety of power purchases available, many on a short- or interim-term basis. By creating a preapproval system for long-term power, a state commission might bias a utility to unduly favor the option of long-term power because of the effective reduction or elimination of regulatory risk and the shifting of market risk away from the utility and to the ratepayer. It is unlikely that this would lead to a more efficient use of utility facilities and resources. However, an argument might be made that by providing that long-term purchased power has a reasonable assurance of fuel adequacy a utility's resources are being used more effectively because the utility would need to provide less of a reserve to back-up the potential that the long-term power supply would fail to deliver. Preconditioning preapproval of a purchased power contract on reasonable assurance of fuel supply adequacy, however, has similar problems as preapproving long-term purchased power; namely, the shifting of market risks that can lead to an overreliance on long-term purchased power. Preapproval mechanisms do not lead to an efficient use of utility facilities and resources.

The final Title I purpose against which a standard is to be considered has already been touched upon. Any form of a preapproval mechanism has the potential of resulting in inequitable rates for ratepayers because preapproval shifts market risks from the utility to the ratepayer. Some may contend that such risk-shifting would be made equitable if a utility faced a commensurately lower rate of return, resulting in lower rates to ratepayers. However, in such a case, as discussed above, a preapproval mechanism

might bias the utility's use of facilities and choice of resources, leading to inefficiencies. That would violate another Title I purpose.¹⁴

Summary

In summary, a state commission would be hard pressed to find that the EPACT section 712 standards carry out the purposes of Title I. However, this should not be surprising. Some have described the section 712 standard as a "utility give away" that was part of the overall compromise of getting the enactment of Title VII. Concerns about section 712, discussed earlier, are summarized in Table 2.

The section 712 standards have little to do with the purposes of PURPA Title I. Indeed, state commissions might do well to consider using a more light-handed regulatory approach of performance-based incentives to tie purchased power, including long-term, into a regulatory scheme that is rational for more competitive and open wholesale power markets. The heavy-handed regulatory approach suggested by the standards of EPACT section 712 does not serve the purposes of Title I well and ignores the need for regulators to change and adapt to the industry restructuring that is likely to result from EPACT.

On the other hand, state commissions have more time to consider whether the EPACT efficiency standards of section 111 and 115 serve the purposes of PURPA Titles

¹⁴ Additional reasons for being cautious about preapproval mechanisms of the sort proposed here are contained in several previous NRRRI publications. See Russell Profozich and Robert E. Burns, *Commission Preapproval of Utility Investments* (Columbus, Ohio: The National Regulatory Research Institute, 1981, reissued 1987); Robert E. Burns et al., *The Prudent Investment Test in the 1980s* (Columbus, Ohio: The National Regulatory Research Institute, 1986); Kenneth Rose and Robert E. Burns, *Overview and Discussion of the Key Regulatory Issues in Implementing the Electric Utility Provisions of the Clean Air Act Amendments of 1990: An Interim Report* (Columbus, Ohio: The National Regulatory Research Institute, 1991); and Kenneth Rose et al., *Public Utility Commission Implementation of the Clean Air Act's Allowance Trading Program* (Columbus, Ohio: The National Regulatory Research Institute, 1992).

TABLE 2

EPACT SECTION 712 STANDARD ON THE PURCHASE OF LONG-TERM WHOLESALE POWER

Section 712's Four Evaluations	Primary Topic(s)	Affected Wholesalers	Primary Issues	The Purposes of PURPA Title I are to encourage:
712 (i)	Cost of capital and retail rate impacts	All wholesalers	<ul style="list-style-type: none"> - Risk allocation between IOUs and ratepayers - Revenue assurance to wholesalers and host utility 	<ul style="list-style-type: none"> (1) Conservation of energy supplied by electric utilities, (2) Optimization of the efficient use of electric utility facilities and (3) Equitable rates to electric consumers
712 (ii)	Debt/equity ratio and reliability	EWGs only	<ul style="list-style-type: none"> - Revenue assurance to host utility - Supply assurance to host utility 	
712 (iii)	Contract preapproval	All wholesalers	<ul style="list-style-type: none"> - Revenue assurance to host utility and wholesaler 	
712 (iv) (Precondition for (iii))	Fuel supply adequacy (Precondition for contract preapproval)	All wholesalers	<ul style="list-style-type: none"> - Revenue assurance to host utility - Supply assurance to host utility 	
Source: Authors.				

I and III. The challenge is to read these provisions "in pari materia" with other provisions of EPACT. One topic worthy of debate is whether IRP is sensible in light of the more open and competitive markets envisioned by EPACT Title VII and FERC Order 636. What are appropriate incentives for energy conservation, demand-side management, and energy efficiency in more competitive markets? What types of regulatory incentives are sensible in light of more open and competitive markets? These topics will be taken up in later NRRI reports on state commission implementation of EPACT.

APPENDIX A

Selected Provisions of the Public Utility Regulatory Policies Act of 1978 as Amended

P.L. 95-617, November 9, 1978, as amended by P.L. 96-294, June 30, 1980, P.L. 98-620, November 8, 1984, P.L. 99-495, October 16, 1986, P.L. 101-575, November 15, 1990, and P.L. 102-486, October 24, 1992

(19) The term "integrated resource planning" means, in the case of an electric utility, a planning and selection process for new energy resources that evaluates the full range of alternatives, including new generating capacity, power purchases, energy conservation and efficiency, cogeneration and district heating and cooling applications, and renewable energy resources, in order to provide adequate and reliable service to its electric customers at the lowest system cost. The process shall take into account necessary features for system operation, such as diversity, reliability, dispatchability, and other factors of risk; shall take into account the ability to verify energy savings achieved through energy conservation and efficiency and the projected durability of such savings measured over time; and shall treat demand and supply resources on a consistent and integrated basis.

(20) The term "system cost" means all direct and quantifiable net costs for an energy resource over its available life, including the cost of production, distribution, transportation, utilization, waste management, and environmental compliance.

(21) The term "demand side management" includes load management techniques.

TITLE I--RETAIL REGULATORY POLICIES FOR ELECTRIC UTILITIES

Subtitle A--General Provisions

Sec. 101. Purposes.

The purposes of this title are to encourage--

- (1) conservation of energy supplied by electric utilities;
- (2) the optimization of the efficiency of use of facilities and resources by electric utilities; and
- (3) equitable rates to electric consumers.

Subtitle B--Standards for Electric Utilities

Sec. 111. Consideration and Determination Respecting Certain Ratemaking Standards.

(a) CONSIDERATION AND DETERMINATION.--Each State regulatory authority (with respect to each electric utility for which it has rate-making authority) and each nonregulated electric utility shall consider each standard established by subsection (d) and make a determination concerning whether or not it is appropriate to implement such standard to carry out the purposes of this title. For purposes of such consideration and determination in accordance with subsections (b) and (c), and for purposes of any review of such consideration and determination in any court in accordance with section 123, the purposes of this title supplement otherwise applicable State law. Nothing in this subsection prohibits any State regulatory authority or nonregulated electric utility from making any determination that it is not appropriate to implement any such standard, pursuant to its authority under otherwise applicable State law.

(b) PROCEDURAL REQUIREMENTS FOR CONSIDERATION AND DETERMINATION.--
(1) The consideration referred to in subsection (a) shall be made after public notice and hearing. The determination referred to in subsection (a) shall be--

(A) in writing,

(B) based upon findings included in such determination and upon the evidence presented at the hearing, and

(C) available to the public.

(2) Except as otherwise provided in paragraph (1), in the second sentence of section 112(a), and in sections 121 and 122, the procedures for the consideration and determination referred to in subsection (a) shall be those established by the State regulatory authority or the nonregulated electric utility.

(c) IMPLEMENTATION.--(1) The State regulatory authority (with respect to each electric utility for which it has ratemaking authority) or nonregulated electric utility may, to the extent consistent with otherwise applicable State law--

(A) implement any such standard determined under subsection (a) to be appropriate to carry out the purposes of this title, or

(B) decline to implement any such standard.

(2) If a State regulatory authority (with respect to each electric utility for which it has ratemaking authority) or nonregulated electric utility declines to implement any standard established by subsection (d) which is determined under subsection (a) to be appropriate to carry

out the purposes of this title, such authority or nonregulated electric utility shall state in writing the reasons therefor. Such statement of reasons shall be available to the public.

(3) If a State regulatory authority implements a standard established by subsection (d)(7) or (8), such authority shall--

(A) consider the impact that implementation of such standard would have on small businesses engaged in the design, sale, supply, installation or servicing of energy conservation, energy efficiency or other demand side management measures, and

(B) implement such standard so as to assure that utility actions would not provide such utilities with unfair competitive advantages over such small businesses.

(d) ESTABLISHMENT.--The following Federal standards are hereby established:

(7) INTEGRATED RESOURCE PLANNING.--Each electric utility shall employ integrated resource planning. All plans or filings before a State regulatory authority to meet the requirements of this paragraph must be updated on a regular basis, must provide the opportunity for public participation and comment, and contain a requirement that the plan be implemented.

(8) INVESTMENTS IN CONSERVATION AND DEMAND MANAGEMENT.--The rates allowed to be charged by a State regulated electric utility shall be such that the utility's investment in and expenditures for energy conservation, energy efficiency resources, and other demand side management measures are at least as profitable, giving appropriate consideration to income lost from reduced sales due to investment in and expenditures for conservation and efficiency, as its investments in and expenditures for the construction of new generation, transmission, and distribution equipment. Such energy conservation, energy efficiency resources and other demand side management measures shall be appropriately monitored and evaluated.

(9) ENERGY EFFICIENCY INVESTMENT IN POWER GENERATION AND SUPPLY.--The rates charged by any electric utility shall be such that the utility is encouraged to make investments in, and expenditures for, all cost-effective improvements in the energy efficiency of power generation, transmission and distribution. In considering regulatory changes to achieve the objectives of this paragraph, State regulatory authorities and nonregulated electric utilities shall consider the disincentives caused by existing ratemaking policies, and practices, and consider incentives that would encourage better maintenance, and investment in more efficient power generation, transmission and distribution equipment.

(10) CONSIDERATION OF THE EFFECTS OF WHOLESALE POWER PURCHASES ON UTILITY COST OF CAPITAL; EFFECTS OF LEVERAGED CAPITAL STRUCTURES ON THE RELIABILITY OF WHOLESALE POWER SELLERS; AND ASSURANCE OF ADEQUATE FUEL SUPPLIES.--(A) To the extent that a State regulatory authority required or allows electric utilities for which it has ratemaking authority to consider the purchase of long-term wholesale power supplies as a means of meeting electric demand, such authority shall perform a general evaluation of:

(i) the potential for increases or decreases in the costs of capital for such utilities, and any resulting increases or decreases in the retail rates paid by electric consumers, that may result from purchases of long-term wholesale power supplies in lieu of the construction of new generation facilities by such utilities;

(ii) whether the use by exempt wholesale generators (as defined in section 32 of the Public Utility Holding Company Act of 1935) of capital structures which employ proportionally greater amounts of debt than the capital structures of such utilities threatens reliability or provides an unfair advantage for exempt wholesale generators over such utilities;

(iii) whether to implement procedures for the advance approval or disapproval of the purchase of a particular long-term wholesale power supply; and

(iv) whether to require as a condition for the approval of the purchase of power that there be reasonable assurances of fuel supply adequacy.

(B) For purposes of implementing the provisions of this paragraph, any reference contained in this section to the date of enactment of the Public Utility Regulatory Policies Act of 1978 shall be deemed to be a reference to the date of enactment of this paragraph.

(C) Notwithstanding any other provision of Federal law, nothing in this paragraph shall prevent a State regulatory authority from taking such action, including action with respect to the allowable capital structure of exempt wholesale generators, as such State regulatory authority may determine to be in the public interest as a result of performing evaluations under the standards of subparagraph (A).

(D) Notwithstanding section 124 and paragraphs (1) and (2) of section 112(a), each State regulatory authority shall consider and make a determination concerning the standards of subparagraph (A) in accordance with the requirements of subsections (a) and (b) of this section, without regard to any proceedings commenced prior to the enactment of this paragraph.

(E) Notwithstanding subsections (b) and (c) of section 112, each State regulatory authority shall consider and make a determination concerning whether it is

appropriate to implement the standards set out in subparagraph (A) not later than one year after the date of enactment of this paragraph.

Sec. 112. Obligations to Consider and Determine.

(a) REQUEST FOR CONSIDERATION AND DETERMINATION.--Each State regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated electric utility may undertake the consideration and make the determination referred to in section 111 with respect to any standard established by section 111(d) in any proceeding respecting the rates of the electric utility. Any participant or intervenor (including an intervenor referred to in section 121) in such a proceeding may request, and shall obtain, such consideration and determination in such proceeding. In undertaking such consideration and making such determination in any such proceeding with respect to the application to any electric utility of any standard established by section 111(d), a State regulatory authority (with respect to any electric utility for which it has ratemaking authority) or nonregulated electric utility may take into account in such proceeding--

(1) any appropriate prior determination with respect to such standard--

(A) which is made in a proceeding which takes place after the date of the enactment of this Act, or

(B) which was made before such date (or is made in a proceeding pending on such date) and complies, as provided in section 124, with the requirement of this title; and

(2) the evidence upon which such prior determination was based (if such evidence is referenced in such proceeding).

(b) TIME LIMITATIONS.--(1) Not later than two years after the date of the enactment of this Act (or after the enactment of the Comprehensive National Energy Policy Act in the case of standards under paragraphs (7), (8), and (9) of section 111(d)), each State regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated electric utility shall commence the consideration referred to in section 111, or set a hearing date for such consideration, with respect to each standard established by section 111(d).

(2) Not later than three years after the date of the enactment of this Act (or after the enactment of the Comprehensive National Energy Policy Act in the case of standards under paragraphs (7), (8), and (9) of section 111(d)), each State regulatory authority (with respect to each electric utility for which it has ratemaking authority), and each nonregulated electric utility, shall complete the consideration, and shall make the determination, referred to in section 111 with respect to each standard established by section 111(d).

(c) FAILURE TO COMPLY.--Each State regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated electric utility shall undertake the consideration, and make the determination, referred to in section 111 with respect to each standard established by section 111(d) in the first rate proceeding commenced after the date three years after the date of enactment of this Act respecting the rates of such utility if such State regulatory authority or nonregulated electric utility has not, before such date, complied with subsection (b)(2) with respect to such standard.

Sec. 117. Relationship to State Law.

(a) REVENUE AND RATE OF RETURN.--Nothing in this title shall authorize or require the recovery by an electric utility of revenues, or of a rate of return, in excess of, or less than, the amount of revenues or the rate of return determined to be lawful under any other provision of law.

(b) STATE AUTHORITY.--Nothing in this title prohibits any State regulatory or nonregulated electric utility from adopting, pursuant to State law, any standard or rule affecting electric utilities which is different from any standard established by this subtitle.

(c) FEDERAL AGENCIES.--With respect to any electric utility which is a Federal agency, and with respect to the Tennessee Valley Authority when it is treated as a State regulatory authority as provided in section 3(17), any reference in section 111 or 113 to State law shall be treated as a reference to Federal law.

Subtitle C--Intervention and Judicial Review

Sec. 121. Intervention in Proceedings.

(a) AUTHORITY TO INTERVENE AND PARTICIPATE.--In order to initiate and participate in the consideration of one or more of the standards established by subtitle B or other concepts which contribute to the achievement of the purposes of this title, the Secretary, any affected electric utility may intervene and participate as a matter of right in any ratemaking proceeding or other appropriate regulatory proceeding relating to rates or rate design which is conducted by a State regulatory authority (with respect to an electric utility for which it has ratemaking authority) or by a nonregulated electric utility.

(b) ACCESS TO INFORMATION.--Any intervenor or participant in a proceeding described in subsection (a) shall have access to information available to other parties to the proceeding if such information is relevant to the issues to which his intervention or participation in such proceeding relates. Such information may be obtained through reasonable rules relating to discovery of information prescribed by the State regulatory authority (in the case of proceedings

concerning electric utilities for which it has ratemaking authority) or by the nonregulated electric utility (in the case of a proceeding conducted by a nonregulated electric utility).

(c) EFFECTIVE DATE; PROCEDURES.--Any intervention or participation under this section, in any proceeding commenced before the date of the enactment of this Act but not completed before such date, shall be permitted under this section only to the extent such intervention or participation is timely under otherwise applicable law.

Sec. 122. Consider Representation.

(a) COMPENSATION FOR COSTS OF PARTICIPATION OR INTERVENTION.--(1) If no alternative means of assuring representation of electric consumers is adopted in accordance with subsection (b) and if an electric consumer of an electric utility substantially contributed to the approval, in whole or in part, of a position advocated by such consumer in a proceeding concerning such utility, and relating to any standard set forth in subtitle B, such utility shall be liable to compensate such consumer (pursuant to paragraph (2)) for reasonable attorney's fees, expert witness fees, and other reasonable costs incurred in preparation and advocacy of such position in such proceeding (including fees and costs of obtaining judicial review of any determination made in such proceeding with respect to such position).

(2) A consumer entitled to fees and costs under paragraph (1) may collect such fees and costs from an electric utility by bringing a civil action in any State court of competent jurisdiction, unless the State regulatory authority (in the case of proceeding concerning a State regulated electric utility) or nonregulated electric utility (in the case of a proceeding concerning such nonregulated electric utility) has adopted a reasonable procedure pursuant to which such authority or nonregulated electric utility--

(A) determines the amount of such fees and costs, and

(B) includes an award of such fees and costs in the proceeding.

(3) The procedure adopted by such State regulatory authority or nonregulated utility under paragraph (2) may include a preliminary proceeding to require that--

(A) as a condition of receiving compensation under such procedure such consumer demonstrate that, but for the ability to receive such award, participation or intervention may be a significant financial hardship for such consumer, and

(B) persons with the same or similar interests have a common legal representative in the proceeding as a condition to receiving compensation.

(b) ALTERNATIVE MEANS.--Compensation shall not be required under subsection (a) if

the State, the State regulatory authority, or the nonregulated electric utility have provided an alternative means for providing adequate compensation to persons

- (1) who have, or represent, an interest--
 - (A) which would not otherwise be adequately represented in the proceeding, and
 - (B) representation of which is necessary for a fair determination in the proceeding, and
- (2) who are, or represent an interest which is, unable to effectively participate or intervene in the proceeding because such person cannot afford to pay reasonable attorneys' fees, except witness fees, and other reasonable costs of preparing for, and participating or intervening in, such proceeding (including fees and costs of obtaining judicial review of such proceeding).

TITLE III--RETAIL POLICIES FOR NATURAL GAS UTILITIES

Sec. 301. Purposes; Coverage.

- (a) PURPOSES.--The purposes of this title are to encourage--
 - (1) conservation of energy supplied by gas utilities;
 - (2) the optimization of the efficiency of use of facilities and resources by gas utility systems; and
 - (3) equitable rates to gas consumers of natural gas.

Sec. 302. Definitions.

For purposes of this title--

(9) The term "integrated resource planning" means, in the case of a gas utility, planning by the use of any standard, regulation, practice, or policy to undertake a systematic comparison between demand-side management measures and the supply of gas by a gas utility to minimize life-cycle costs of adequate and reliable utility services to gas consumers. Integrated resource planning shall take into account necessary features for system operation such as diversity, reliability, dispatchability, and other factors of risk and shall treat demand and supply to gas consumers on a consistent and integrated basis.

- (10) The term "demand-side management" includes energy conservation, energy

efficiency, and load management techniques.

Sec. 303. Adoption of Certain Standards.

(a) ADOPTION OF STANDARDS.--Not later than 2 years after the date of the enactment of this Act (or after enactment of the Energy Policy act of 1992 in the case of standards under paragraphs (3) and (4) of subsection (b)), each State regulatory authority (with respect to each gas utility for which it has ratemaking authority) and each nonregulated gas utility shall provide public notice and conduct a hearing respecting the standards established by subsection (b) and, on the basis of such hearing, shall--

(2) adopt the standards established by paragraphs (2), (3) and (4) of subsection (b) if, and to the extent, such authority or nonregulated utility determines that such adoption is appropriate to carry out the purposes of this title, is otherwise appropriate, and is consistent with otherwise applicable State law.

For purposes of any determination under paragraphs (1) and (2) and any review of such determination in any court under section 307, the purposes of this title supplement State law. Nothing in this subsection prohibits any State regulatory authority or nonregulated utility from making any determination that it is not appropriate to implement any such standard, pursuant to its authority under otherwise applicable State law.

(b) ESTABLISHMENT.--The following Federal standards are hereby established:

(3) INTEGRATED RESOURCE PLANNING.--Each gas utility shall employ, in order to provide adequate and reliable service to its gas customers at the lowest system cost. All plans or filings of a State regulated gas utility before a State regulatory authority to meet the requirements of this paragraph shall (A) be updated on a regular basis, (B) provide the opportunity for public participation and comment, (C) provide for methods of validating predicted performance, and (D) contain a requirement that the plan be implemented after approval of the State regulatory authority. Subsection (c) shall not apply to this paragraph to the extent that it could be construed to require the State regulatory authority to extend the record of a State proceeding in submitting reports to the Federal Government.

(4) INVESTMENTS IN CONSERVATION AND DEMAND MANAGEMENT.--The rates charged by any State regulated gas utility shall be such that the utility's prudent investment in, and expenditures for, energy conservation and load shifting programs and for other demand-side management measures which are consistent with the findings and purposes of the Energy Policy act of 1992 are at least as profitable (taking into account the income lost due to reduced sales resulting from such programs) as prudent investment in, and expenditures for, the acquisition or construction of supplies and facilities. This objective requires that (A) regulators link the utility's net revenues, at least in part, to the utility's performance in implementing cost-effective programs

promoted by this section; and (B) regulators ensure that, for purposes of recovering fixed costs, including its authorized return, the utility's performance is not affected by reductions in its retail sales volumes.

(c) **PROCEDURAL REQUIREMENTS.**--Each State regulatory authority (with respect to each gas utility for which it has ratemaking authority) and each nonregulated gas utility, within the two-year period specified in subsection (a), shall adopt, pursuant to subsection (a), each of the standards established by subsection (b) or, with respect to any such standard which is not adopted, such authority or nonregulated gas utility shall state in writing that it has determined not to adopt such standard, together with the reasons for such determination. Such statement of reasons shall be available to the public.

(d) **SMALL BUSINESS IMPACTS.**--If a State regulatory authority implements a standard established by subsection (b)(3) or (4), such authority shall--

(1) consider the impact that implementation of such standard would have on small businesses engaged in the design, sale, supply, installation, or servicing of energy conservation, energy efficiency, or other demand-side management measures, and

(2) implement such standard so as to assure that utility actions would not provide such utilities with unfair competitive advantages over such small businesses.

TIME LINE

October 24, 1992

October 23, 1993

October 23, 1994

October 23, 1995

Enactment of EPACT			
Consideration of EPACT section 712 standard(s)	(No grandfathering)		
Deadline for determination of whether to adopt EPACT section 712 standard(s)			
Consideration of EPACT section 111 standards	-----		(Grandfathering permitted)
Deadline for determination of whether to adopt EPACT section 111 standards			
Consideration of EPACT section 115 standards	-----		(Grandfathering permitted)
Deadline for determination of EPACT section 115 standards			

Consideration Periods:

Mandatory _____

Optional - - - - -