

# Client Alert

## FERC Revisits Regulatory Treatment of Qualifying Facilities

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On July 16, 2020, the Federal Energy Regulatory Commission (“**FERC**”) issued its final rule changes to the Public Utility Regulatory Policies Act of 1978 (“**PURPA**”) meant to modernize FERC’s PURPA rules by limiting the size of renewables projects that receive special regulatory treatment under PURPA and providing new flexibility to state regulatory authorities.<sup>1</sup> The PURPA Order passed by a 3-1 vote, with Commissioner Richard Glick dissenting in part, and closely tracks FERC’s PURPA reform proposal issued last year. FERC’s PURPA rules were originally promulgated in 1980 and, as required by the U.S. Congress in PURPA, were designed to encourage the development of small power production and cogeneration facilities, known as qualifying facilities (“**QFs**”). Except for limited changes required by the Energy Policy Act of 2005, the original PURPA regulations had remained largely unmodified until now.

Specifically, the PURPA Order makes changes to certain aspects of a QF’s regulatory treatment, including: (i) lowering the QF capacity threshold for giving rise to a utility mandatory purchase obligation; (ii) adjustments to the rate a utility is required to pay a QF for its energy; (iii) changes to the aggregation rules for determining whether affiliated QFs are located at the same site; and (iv) certain associated administrative and procedural adjustments. Notably, however, the PURPA Order left intact other aspects of FERC’s regulation of QFs, including, importantly, QF exemption from certain regulatory requirements under the Federal Power Act and state laws governing utility rates and financial organization. The PURPA Order also does not permit disturbance of existing QF contracts or existing facility certifications.

### Entitlement to Utility Mandatory Purchase Obligation

For QFs operating in organized markets, FERC’s PURPA Order establishes a new rebuttable presumption that QFs (excluding cogeneration facilities) with a net capacity at or below 5 MW do not have nondiscriminatory access to competitive markets.<sup>2</sup> Under PURPA’s regulatory scheme, if a QF is presumed **not** to have non-discriminatory market access, it can force a utility to purchase its power, referred to as the “mandatory purchase obligation”, at a rate not exceeding the utility’s “avoided cost” (i.e., the utility’s cost to produce the power itself or contract from another source). The rebuttable presumption previously applied to QFs at or below 20 MW, which remains the threshold for cogeneration QFs.

<sup>1</sup> Qualifying Facility Rates and Requirements, Implementation Issues under the Public Utility Regulatory Policies Act of 1978, Order No. 872, 172 FERC ¶ 61,041 (2020) (the “**PURPA Order**”).

<sup>2</sup> PURPA Order at P 625.

Accordingly, the PURPA Order relieves most utilities in organized wholesale markets from the mandatory purchase obligation for non-cogeneration QFs over 5 MW.

Yet, FERC left open the possibility that QFs between 5 MW and 20 MW lack nondiscriminatory access to wholesale markets and provided examples of factors that could be used to establish such a finding, including unique characteristics surrounding the location, operation, or purpose of the specific generating facility.<sup>3</sup> FERC stated that it would consider such claims on a case-by-case basis.

### **Rate Setting Mechanisms**

Perhaps one of the most significant and controversial changes adopted in the PURPA Order is FERC's granting to state regulatory authorities the flexibility to require that energy rates (but not capacity rates) in QF power sales contracts vary according to changes in the purchasing electric utility's avoided costs at the time the QF's energy is delivered, the so called "as available" energy rate.<sup>4</sup> Previously, a QF could elect to have a fixed energy rate over a specified contract term, which gave certain QF developers access to a stable payment stream.

The PURPA Order also allows states to calculate QFs' "as available" energy rates in several different ways, including based on the locational marginal price ("**LMP**") established in organized electric markets by creating a "rebuttable presumption" that LMP represents the purchasing utility's avoided cost. For QFs selling to utilities outside of an organized electric market, states may set as-available rates based on competitive prices derived from: (i) liquid market hubs; (ii) a formula based on natural gas price indices and specified heat rates; or (iii) a competitive solicitation process.

### **QF Aggregation**

FERC modified its "one-mile rule" for determining whether affiliated generation facilities are considered to be at "the same site" for purposes of analyzing a facility's qualification as a QF. Specifically, FERC will allow interested parties to "show that affiliated small power production facilities that use the same energy resource and are more than one mile apart and less than 10 miles apart actually are at the same site (with distances one mile or less apart irrebuttably at the same site, and distances 10 miles or more apart irrebuttably at separate sites)."<sup>5</sup> FERC also provided guidance for evaluating whether or not facilities are at the same site by adopting certain physical and ownership factors.<sup>6</sup>

This rule change is designed to curb the alleged practice of some renewables developers who sought to avoid application of FERC's 80 MW limit for qualifying as a QF by building multiple smaller generation facilities just over one mile apart. The change applies to new QF self-certification or FERC certification filings and to recertification filings involving substantive changes to an existing QF.

### **Procedural Changes**

Finally, FERC made a number of administrative and procedural changes for QFs. First, FERC will allow an interested party to directly challenge a QF's initial certification or recertification by filing a protest, rather than being required to file a separate petition for declaratory order, which carries a significant filing fee of approximately \$30,000.<sup>7</sup> Such protests are required to be filed at FERC within 30 days of the date an applicant files its FERC Form No. 556, which is the most common method by which an entity certifies to FERC that its facility meets the requirements of QF status.<sup>8</sup> FERC also modified the FERC Form No. 556 to collect certain additional information necessary to implement the above regulatory changes.<sup>9</sup>

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<sup>3</sup> PURPA Order at PP 640-44.

<sup>4</sup> PURPA Order at P 57.

<sup>5</sup> PURPA Order at P 62.

<sup>6</sup> PURPA Order at P 508.

<sup>7</sup> PURPA Order at PP 547-48.

<sup>8</sup> PURPA Order at P 554.

<sup>9</sup> PURPA Order at P 584.

## Implications of the PURPA Order on QF Development

The PURPA Order marks a significant change in FERC's approach to QF regulation, in particular for its regulation of non-cogeneration QFs between 5 MW and 20 MW which have had the right to force utilities to purchase their output since the early 1980's. This threshold change is likely to have a disproportionate impact on solar generation in the U.S., which accounts for a larger share of new renewable generation under 20 MW. FERC's revisions to its longstanding one-mile rule will likely present some regulatory compliance challenges for distributed solar QF projects in densely populated areas, including additional complexity for maintaining exemption from the Public Utility Holding Company Act of 2005, and will also likely require additional due diligence in project financings and M&A transactions involving behind-the-meter assets. Similarly, the rule changes represent a shift in the balance of regulatory authority under PURPA, from FERC to state authorities. State regulatory authorities will have increased flexibility not only in setting the rates QFs are paid for their energy but also to require those rates to fluctuate throughout the term of QF contracts, which may present increased risk and uncertainty for small renewables developers in states with unfavorable regulatory climates. A move by states to variable energy rates may be particularly problematic for QFs located in regions with a heavy reliance on hydroelectric power, as energy prices could collapse during a period of above-normal hydroelectric output. States with policies favorable to renewable energy, including those with aggressive renewable portfolio standards, may not see a significant change.

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This Client Alert provides a summary of certain key elements of the PURPA Order and is not comprehensive as to the full scope of the PURPA Order or other elements of the legal framework, that may relate to or follow from the PURPA Order.

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