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New FERC Order No. 872 Likely to Increase Regulatory Burden on Small Renewable Energy Facilities

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The Federal Energy Regulatory Commission ("FERC" or the "Commission") recently issued Final Order No. 872, which makes sweeping changes to the regulations that implement the Public Regulatory Policies Act of 1978 ("PURPA"). The Order adopts many of the provisions of the Commission's September 2019 Notice of Proposed Rulemaking ("NOPR") on the topic. Describing the changes as an effort to "modernize the Commission's interpretation of PURPA," the new regulations usher in the most significant changes to PURPA's implementation since the Commission first enacted regulations in 1980. The regulatory changes will surely impact numerous aspects of the electricity market, and, as discussed here, have the potential to increase the regulatory burden on small renewable energy facilities, and add challenges to financing such projects.

Increased Regulatory Burden on QFs

PURPA designates certain cogeneration and small power production facilities as "qualifying facilities" or "QFs" under federal law. Obtaining QF status has several benefits, including conferring the right to sell electricity at a utility's avoided cost—described in detail below—and reducing the regulatory burden on a facility. To meet the requirements of a small power production facility, a project must have a production capacity of less than 80 megawatts and generate electricity primarily from renewable resources, geothermal resources, biomass, or waste. To obtain QF status, a facility generally must self-certify that it meets all of the requirements of a qualifying facility by filing a Form 556.

Small power production facilities of 20 MW or smaller are also exempt from the Commission's rate regulation under Sections 205 and 206 of the Federal Power Act. In this way, PURPA has been critical in supporting the development of renewable resources like solar and wind.

One-Mile Rule

Although Order No. 872 leaves much of this basic structure intact, the new rules have the potential to increase significantly the regulatory burden on smaller facilities in several respects.

First, Order No. 872 modifies the rules for determining whether generation facilities are considered to be at the same site—those within the same site are added together to determine whether a facility meets the size limitations defining a small power production facility. Under current law—colloquially known as the "one-mile rule"—the Commission uses a simple bright-line rule that treats all generation facilities within one mile of one another as a single facility when making this determination. The new rule modifies this approach by adopting two irrebuttable presumptions: first, that facilities located within one mile of each other are deemed part of the same site and, second, that facilities located more than 10 miles from each other are deemed *not* to be part of the same site. For facilities in the middle category—those located more than one mile but less than ten miles from one another—the Commission will apply a rebuttable presumption that such facilities are *not* part of the same site. In adopting this reform, the Commission cited a concern that QF developers were circumventing the one-mile rule "by strategically siting small power production facilities that use the same energy resource slightly more than one mile apart in order to qualify as" separate facilities. The one-mile rule is particularly critical for renewable resources, like solar and wind resources, which are often located relatively close together to simplify interconnection to the electricity grid.

Under the new rule, FERC will determine whether small power production facilities located more than one but less than 10 miles apart are at the "same site" by considering the <u>physical characteristics</u> of the facilities (such as common infrastructure, property ownership, leases, and interconnection facilities) and <u>ownership/other characteristics</u> (such as whether the facilities are owned by the same or affiliated persons, are operated and maintained by the same or affiliated entities, sell to the same electric utility, and maintain common financing).

Entities filing a new self-certification or recertification will now be required to identify affiliated facilities whose nearest electrical generating equipment is greater than one mile but less than 10 miles from the electrical generating equipment of the instant facility. Additionally, filers may feel compelled to explain in their self-certification why the identified facilities should be considered separate facilities. In addition to the risk that a facility's QF status could be challenged—described in greater detail below—this new reporting requirement will surely increase the regulatory burden on the owner of several renewable energy facilities.

Notably, however, the Commission's change to the one-mile rule is effective as of the date of the final rule. This means that existing QFs will not face any additional scrutiny unless and until they file a self-recertification with the Commission.

<u>New Protest Procedure</u>

Order No. 872 also makes it much easier to challenge a facility's self-certification. Under current law, an entity that wishes to challenge a self-certification or self-recertification must file a petition for a declaratory order and pay a sizable $30,000 filing fee. Under the revised rule, an interested person or entity can seek to intervene and file a protest without clearing these hurdles.

Under the new procedure, no fee is required. An interested person must file its challenge within 30 days from the date of the filing of the Form 556 (the document used to self-certify or recertify that a facility meets the requirements of a qualifying facility) and serve its protest on the Form 556 applicant. The protesting party bears the burden of making a prima facie showing that the facility does not meet the requirements for QF status. Thus, the Commission has cautioned that "[g]eneral allegations that the facility is not a QF without reference to the specific regulatory provision that has not been satisfied" do not suffice. However, if the challenger makes out a prima facie case, "the burden would shift to the applicant . . . to demonstrate that the claims raised in the protest are incorrect and that certification is, in fact, warranted."

Once a petition is filed, the Commission will have 90 days to issue an order determining a facility's QF status. The Commission may extend that period if it requests additional information or tolls the time period to respond by 60 days. If the Commission does not respond in time, the protest will be deemed denied.

Although the new protest procedure has the potential to increase the regulatory burden on QFs, a few aspects of the new rule will likely mitigate these effects. Regardless of whether a protest is filed, QF self-certifications will remain effective from the date of filing unless the Commission revokes the certification, ensuring that frivolous or unsuccessful protests do not create a gap in certification.

Moreover, in response to comments posed by industry groups, the Commission has granted "legacy treatment to existing QFs under certain circumstances." Critically, as a general matter "protest pursuant to [the new] rule will not be allowed to QF certifications and recertifications . . . that are submitted *before the effective date of the final rule*." Additionally, protests to self-recertifications may only be filed where the recertification "makes substantive changes to the existing certification." Examples of "substantive changes" include "a change in electrical generating equipment that increases power production capacity by the greater of 1 MW or 5 percent of the previously certified capacity of the QF, or a change in ownership in which an owner increases its equity interest by at least 10% from the equity interest previously reported." Administrative changes made in recertifications do not trigger the new protest procedure.

Despite these limitations, the Commission's amended one-mile rule and protest rule are likely to have the unintended consequence of discouraging the sale or transfer of existing QFs, particularly those facilities affected by the new greater-than-one-but-less-than-ten-mile rebuttable presumption.

Increased Challenges for Financing

Impact on QF Rates

Under PURPA, the Commission is obligated to promulgate rules that ensure that electric utilities do not pay rates for QF-produced energy that exceed the purchasing utility's "incremental cost . . . of alternative electric energy," otherwise known as the "avoided cost." In addition, these rates are to be just and reasonable, and may not discriminate against qualifying cogenerators or qualifying small power producers. Prior to the new rule, QFs had two options for selling energy to utilities—on an as-available basis for the avoided cost at the time of delivery ("as-available"), or pursuant to a contract or other legally enforceable obligation ("LEO") over a specified term for an avoided cost either calculated at the time of delivery or fixed at the time the LEO was incurred.

For small renewables generators, the Order's modifications to the contract or LEO option could be significant. As a threshold matter, the new rule allows states to establish "objective and reasonable" criteria to determine a QF's commercial viability and financial commitment to construction before a QF may establish a LEO. Such added criteria have the potential to increase developer challenges if more equity must be raised to fund additional costs that may be imposed. Moreover, under the new rule, states are no longer required to provide QFs a contract option with a fixed energy rate. This change is specific to QFs, and because fixed energy rates continue to be drivers for the financeability of QFs, the Commission's determination appears to ignore the realities inherent in its non-discrimination mandate, adds uncertainty in QF rates, and ultimately adds uncertainty for financing, providing states that want to oppose renewable energy projects an avenue to do so.

To be clear, states are not obligated to eliminate the availability of fixed energy rates, and states are still required to provide QFs contracts with fixed capacity rates. Indeed, the new rule provides that states can continue to establish fixed rates—which may now include rates based on estimates of forecasted energy prices at the time of delivery over the anticipated life of the contract. In addition, under the new rule, states may set variable rates for energy, based on the purchasing utility's avoided costs at the time of delivery, and they may also set avoided energy and/or capacity rates using competitive solicitations in a transparent and non-discriminatory manner.

In addition, for QFs selling on an as-available basis in an organized wholesale market (i.e. where there is Regional Transmission Organization or an Independent System Operator), the new rule establishes a rebuttable presumption that locational marginal prices ("LMPs") can be used to reflect avoided costs. For those QFs selling on an as-available basis outside of an organized wholesale market, the new rule provides for flexibility for states to set rates at competitive prices from "liquid market hubs," to the extent that the state determines the liquid market hub price to represent the avoided cost, and subject to certain adjustments. Similarly, in jurisdictions outside of wholesale markets, states can set as-available prices based on avoided cost established by published natural gas price indices and a proxy heat rate for an efficient natural gas combined cycle generation. This rebuttable presumption is a slight modification from the NOPR's "per se" application of LMPs as avoided costs, but now places an added burden on QFs to contest their applicability.

<u>Obligation to Purchase</u>

Prior to the new rule, FERC had established a rebuttable presumption that QFs with a capacity greater than 20 MW had non-discriminatory access to competitive markets, and therefore, utilities were not obligated to purchase from those resources.

Pursuant to this new rule, the Commission has reduced the 20 MW threshold down to a 5 MW capacity for its non-discriminatory access rebuttable presumption, citing "improved" markets—though the Order does not appear to demonstrate with specificity how these presumed improvements support the 15 MW drop. Now, utilities may apply with FERC to request relief from mandatory purchase obligations from QFs between 5 MW and 20 MW. Allowing utilities the ability to challenge the obligation to purchase power from these projects creates yet another challenge for financing.

What's Next?

Although the Commission's new rules have now been publicly issued, several groups have filed a request for rehearing. By regulation, FERC now has 30 days from August 17, 2020 to rule on a rehearing request, and a final order on rehearing could then (but only then) be appealed to the federal courts. Notably, Commissioner Richard Glick dissented in part from Order No. 872, arguing that it "administratively gut[s] PURPA," "attempt[s] to accomplish via administrative fiat what Congress has repeatedly declined to do via legislation," and is "arbitrary and capricious" in violation of the Administrative Procedure Act. Commissioner Glick's dissent provides a roadmap for opponents to challenge the Commission's new regulations.

Additionally, much of the Commission's work in Order No. 872 grants states additional authority to implement PURPA, such as by establishing avoided costs rates and allowing energy rates to vary during the life of a QF contract. It remains to be seen how states will wield this new authority, and states' efforts to implement the new rule may be clouded by judicial review of Order No. 872.