ORIGINAL

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 82-34 & 82-226

TITLE AMERICAN PAPER INSTITUTE, INC.,
Petitioner
v.
AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.
and
FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner
v.
AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.

PLACE Washington, D. C.

DATE March 22, 1983

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IN THE SUPREME COURT OF THE UNITED STATES

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AMERICAN PAPER INSTITUTE, INC., :

Petitioner :

v. : No. 82-34

AMERICAN ELECTRIC POWER SERVICE :

CORPORATION, ET.AL.; and :

FEDERAL ENERGY REGULATORY COMMISSION :

Petitioner :

v. : No. 82-226

AMERICAN ELECTRICAL POWER SERVICE :

CORPORATION, ET AL. :

- -x

Washington, D. C.

Tuesday, March 22, 1983

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:03 a. m.

APPEARANCES:

PAUL M. BATOR, Esq., Department of Justice,
Washington, D. C.; on behalf of the Petitioners

EDWARD BERLIN, Esq., Washington, D. C.;
on behalf of the Respondent

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C O N T E N T S

P R O C E E D I N G S

CHIEF JUSTICE BURGER: We will hear arguments next in American Paper Institute against the American Electric Power Service Corporation.

Mr. Bator, I think you can proceed when you are ready.

ORAL ARGUMENT OF PAUL M. BATOR, ESQ.,

ON BEHALF OF THE PETITIONERS

MR. BATOR: Mr. Chief Justice, and may it please the Court:

This case involves the validity of two rules issued by the Federal Energy Regulatory Commission, FERC. Under Section 210 of the statute commonly known as PURPA, the Public Utility Regulatory Policies Act of 1978.

The Government is here because the Court of Appeals for the District of Columbia circuit held these rules invalid. It is the submission of the Government that the Court of Appeals misread the statute, that the rules are valid, and that the ruling of that Court threatens to cripple an important and an exciting experiment that Congress set on when it enacted PURPA.

I want to start by giving some background to put the arguments made in our brief and our reply brief in context. This Court is of course familiar with PURPA from its decision last term in FERC and Mississippi.

In PURPA Congress embarked on an ambitious attempt to encourage the development of innovative energy efficient

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technology for producing electric power. The central point was to lessen the country's dependance on foreign oil, to end the waste of nonrenewable fossil fuel, and to encourage energy efficiency.

More specifically, Congress sought to tap the tremendous reservoir of potential energy potentially available from renewable sources and from wasted heat produced in industrial and domestic settings.

There are two technologies involved. Cogeneration is the simultaneous production of electricity on the one hand and thermal energy, heat and steam, on the other. Small power production is the generation of relatively small amounts, less than 80 megawatts of electricity, from non-fossil fuel and renewable sources, wind, water, sun, organic materials, and waste.

Cogenerators and small power producers together are referred to as qualifying facilities, QF's for purposes of this case.

In enacting PURPA, Congress found that cogeneration of small power production was hindered historically in this country by two things: the traditional electrical utilities, the interests represented by the Respondent here, sought to preserve their monopoly in the production of electricity by refusing to buy electricity from or selling back of electricity to QF's. Secondly, an uneconomical and rigid regulatory

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enviroment deterred firms from entering the business of unconventional power production.

Behind these two labels, cogeneration and small power production, there is a world of hundreds of variagated technologies. Cogenerators and small power producers come in all sizes and shapes from the $5,000 back-yard windmill producing maybe 10 kilowatts to the enormous paper mill generating maybe 300 to 400 kilowatts of power that may cost several hundred million dollars to build.

QF's use dozens of different fuels from walnut shells to garbage, from sawdust to geothermal brine. Every facility that needs a fair amount of heat is a potential cogenerator, every hospital, school, every laundry, every apartment house. This is a wide-open road. It is open to all comers. It is exactly the opposite of the traditional monopolistic electric utility business.

Now, there are three critical elements in the congressional plan for encouraging cogeneration and small power production. First, Section 210 of PURPA creates a legal obligation on utilities to buy to and sell from QF's . Second, Congress instructed FERC to relieve QF's from the constricting regulatory environment that surrounded the commerce in electrical energy. The third element in the congressional plan was decentralization. The states are to play a critical role.

FERC was given one year to issue general framework rules to state the enterprise, to set it on foot. Implementation was then to go forward at the state level.

I turn now to the first rule in question in this case. Here the Commission addressed the question of what rate is to be paid by a utility buying power from a QF. After extensive rule-making proceedings, FERC determined that a two-track system should be established. Rates for old capacities, cogenerators and small power producers already in existence or under construction, those rates were left on a flexible basis to state commissions. The second track was for new capacities not yet in existence. It was, of course, here that the central PURPA purpose of encouraging new firms to come in was in play.

The rate system for new capacity was itself sub-divided into two tracks: one, rates could be set by negotiation in contracts at any level agreed to by the parties thus allowing the marked full play. Two, if there is no contract, then a PURPA rate system comes into play. The PURPA rate system is that the utility buying power from the QF must pay the QF the full avoided cost of that power. Now, this is in turn subject both to state implementation and state waivers.

QUESTION: Professor Bator, you put the other first and the full avoid cost second. I must confess, having looked at the statute, I looked at it just the reverse.

MR. BATOR: Well, Your Honor, if there had been a physical way to state them together simultaneously, I would have

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because they proceed in tandem. Actually, in the regulations the very first thing in the regulations, the very first of the two, refers to the full play of negotiated and bargained-for rates, and it is later in Section 304 that we get the full avoided rate -- full avoided cost.

I think it is important that there not be a misunderstanding about what the PURPA system and full avoided cost is because we think that the Court of Appeals really had a misunderstanding of it. The Court of Appeals seemed to think that this was a very rigid, flat, single uniform rate.

Full avoided cost is not really a rate at all. It is a rate system. It is a dynamic rate structure. It means simply that the amount paid by the utility to the QF equals the cost the utility would have incurred had that particular quantum of power not been available from the QF if it had to be produced by the utility. Full avoided cost is simply the cost the utility avoided by having the QF power made available. This means that full avoid cost is anything but rigid. It varies from utility to utility. It varies within each utility everytime fuel costs go up and down. When OPEC puts down the price of oil, full avoided cost goes down because the power that would have had to have been produced by the utility would have been less.

Further, it is important to note that even when fuel prices are flat, full avoided cost varies because the unit cost

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of producing electricity is not uniform. The more power a utility has to produce, the higher the unit cost to produce it. It is a firm rule of utility practice that the most efficient, least-costly facilities are turned on first and are turned off last. Thus, a utility may have coal, oil, gas-fired units. At a time of low demand, the low-cost coal-fired units come on line. If demand goes up, the next block of power comes in, the higher-priced fuel-oil-fired units. At times of peak demand, the so-called peakers come on. Those may be the very high-price natural-gas-fired units.

QUESTION: But is it not true, Mr. Bator, that at all times, even though the full avoided cost may be different at different times of the day and so forth, at all times, it is the maximum rate permitted by the statute?

MR. BATOR: The full avoided rate system is the maximum rate permitted by the statute.

QUESTION: Well, and at any given time of day, whatever that rate might be if it is equal to the utility's full avoided cost, it is the highest the statute would permit to be charged.

MR. BATOR: It is the highest that the statute permits.

QUESTION: Yes.

MR. BATOR: But the actual price involved varies not only over these long ranges but will vary even within a given day. At 3:00 a.m. when demand is very low, only the

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very low-cost facilities are on, and the price avoided by the utility is the low price. At 7:00 p.m. when demand high, if there is QF power available, it would be replaced relatively high priced oil.

A QF that is supplying power over 16 or 24 hours a day -- they all do -- does not get just the peak price. It gets the average price. What this means is that full avoided cost, since it depends on the cost of the power it is replacing, it means that the first QF that comes along will always get the highest full avoided cost. It is replacing the most expensive fuel. The next one that comes along will be replacing the next block, less-costly capacity. The third one that comes along will be getting a lower price.

Really, the beauty of the system is that QF capacity replaces the least efficient utility capacity first, and the other beauty of the system is that the more QF power comes in, the lower the full avoided cost. It drives down the full avoided cost because it will be replacing less and less costly utility capacity.

Now, the Court of Appeals invalidated this rule. Why? It did so because it found that the commission did not adequately take into account the interest of electrical utility consumers. The Court of Appeals evidently concluded that full avoided cost system would lead to excessive profits to QF's because cost savings would not be passed on immediately to utilities

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and their customers, and it concluded that this violated the statutory command that the rate be just and reasonable to consumers.

Our submission, Your Honor, is that the Court of Appeals treading in an infinitely complicated and technical area entrusted to an expert commission really misapprehended the statute, misapprehended the commission's regulatory task under the statute, and certainly misunderstood the workings of the PURPA rate.

The Court of Appeals asserted that the statute requires basically that QF profits be limited so that all savings or a lot of savings could immediately pass through to customers. Of course, this is traditional utility regulation. This is cost-of-service regulation in which the return to the seller is limited in terms of the seller's cost, but in this statute Congress made its intention clear. As the conference report which is quoted at length in our reply brief makes clear, Congress did not wish these entities to be subjected to the cumbersome case-by-case cost-of-service regulation traditional in the utility business. In other words, the commission rightly rejected cost-of-service rate making here as a solution because Congress had identified it as the problem.

Rate making pitched to QF cost is really in opposite in this industry for three reasons: the costs are an infinitely variagated set of costs associated with an incredibly complex

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and various form of technology and enterprise. We are talking about future costs. This is new capacity in a rapidly developing and a technologically very volatile field. Most important, we are talking about an industry that is an at-risk open-to-all-comers industry. It is fully competitive. So that the problem of monopoly profits does not exist in this case, and it is in light of this clearly-expressed congressional purpose that FERC determined that rather than rates pitched to the seller's cost, an across-the-board rate set by rule in advance was necessary.

Now, to return to Justice Stevens: why start it at 100 percent of avoided cost? Why not some lower figure? The Court of Appeals suggested that might show a savings in some way with utility customers.

Our answer is that the cost had to be set in advance in a world of uncertainty under a statute whose principal purpose was to entice entrants, new firms, into the business.

Now, from this advanced perspective, this whole picture of savings and excess profits is very misleading. You don't know in advance what the costs of that new QF are going to be.

Here is an illustration. Suppose there is a utility which has an avoided cost at peak times and a peak demand of eight cents a kilowatt hour. It's true that maybe a QF will come along that has only a four-cent cost, and yet under the PURPA

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rate, the utility will have to pay eight cents. You say, "Why not set it at six cents? The QF would still be making a profit and some of the savings could be passed along."

The difficulty is that in advance you don't know whether the QF that is going to come along has a four-cent cost or whether it has a six-cent or a seven-cent or an eight-cent or a ten-cent cost.

QUESTION: Well, the full avoided cost rule really doesn't guarantee any QF a profit, does it?

MR. BATOR: Absolutely no, Your Honor. Absolutely no. It is absolutely a comparative invitation. You can come in as long as you are more efficient than the utility. If in my illustration, the QF's cost is nine cents, it won't come in because it can't get more than eight.

Now, suppose the commission had done that which it is constantly being invited to which is set a rate at less than full avoided cost. Suppose the commission had set a six-cent maximum, 75 percent of full avoided cost. What would be effective then? It would have deterred from the market QF's that could produce electricity at six cents and seven cents. That capacity would never have been built, and if it is never built, what do we have in its place. We have eight-cent utility power. The eight-cent utility power is using low efficiency fossil fuel and not the renewable resource that Congress wishes to encourage in that case.

Finally, the Court of Appeals picture of savings here is misleading because it simply forgets the self-correcting nature of full avoided cost. It may happen that the first one that comes in has four-cent cost and therefore gets a fairly high profit, but that will attract other firms into the business. The next firm won't get that profit because it has to replace lower-cost utility capacity. It drives down.

Under the PURPA plan state commissions are constantly readjusting full avoided cost. Eventually, full avoided cost should come down to a market clearing or equilibrium rate. It is a self-correcting rate.

QUESTION: Does the first QF in a field of a particular utility get kind of a grandfather right to replace the highest cost power?

MR. BATOR: Your Honor, that depends entirely on the state implementation. In a sense what this does is leave it open to the states to work out the details, and there is now going on in every state elaborate rule making. In a lot of states, it is averaged out. There are all kinds of systems being tried out.

The full avoided cost generally is reevaluated from time to time and in some states very, very frequently.

Of course, that really leads me to my next point. There is a way in which you can get a guaranteed grandfather rate, and that is to contract. That's the alternate track. That

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is quite apart from the PURPA rate. The QF and the utility can bargain any rate they wish. In this industry that is essential for the QF because the QF cannot get financing without a long-term contract. The PURPA rate is too risky. It is subject all -- it may be reevaluated by the commission. It is subject to the state implementations. It is subject to every variation in the price of fuel. There is a lot of bargaining going on. QF's have the incentive to bargain because they need long-term stability for financing. Utilities have an incentive to bargain. Why? Because of the PURPA rate. Before the PURPA rate, the utilities had no need to bargain.

The Commission explicitly found that it is the existence of the PURPA maxim that would tilt the utilities into bargaining, and what is happening in the industry? The Southern California experience which has been referred to in the brief shows clearly that contracts are being written, and they are producing savings to utility customers because they are below fully avoided cost.

QUESTION: On that point, one of the objections that the Court of Appeals made was that the commission had not adequately explained its reasoning. I understand your argument. You think it was made in the same terms by the commission that you made it today. In fact, they said in one place that it would not produce any savings for consumers.

MR. BATOR: We think that that sentence, which we

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would have been happier had they not included it in their opinion, in context refers to short-term. It is clear that this system doesn't guarantee short-term savings, but we think that the commission report -- and the commission was operating under the informal rule-making statute of the APA. All its obligation was to give a concise general statement. It did not have to make findings. The standard of review here is not substantial evidence.

We think that the commission's report and its background -- it was a very sensitive staff report here that the commission played off on. There were rules, amendments to the rules. We think that the entire record sensitively read clearly shows that the commission had all these matters in mind.

I will add just one more quick point on this one, and that is it must be remembered that this is all to be considered experimental. The statute explicitly told PURPA, "Do this fast in one year. Send this baby out and let's see what happens. Let the states do the implementation. States can come in and get waivers if they don't like it."

The commission was told explicitly in the statute, "Reevaluate your role." The commission really decided that this PURPA system would eventually replicate market forces. It would maximize the statutory purpose for creating an incentive for new firms to come in all of which, Justice Stevens, without

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a penny of extra costs for the utility costs.

There is no harm either to the utility or to the customer. That is built into the system.

QUESTION: Are there bills pending in Congress to overcome the Court of Appeals decision?

MR. BATOR: If there are, Justice Blackmun, I don't know. I just don't know.

QUESTION: I think you will find there is a bill pending.

MR. BATOR: I am embarrassed to say that I just don't know.

We do feel, Your Honor, that the commission's expert judgment that this was the -- and it was a predictive judgement -- that this was a good way to start this experiment should not have been overturned.

This experiment is really already succeeding. That is, under the PURPA rate there are droves of cogenerators and small power producers coming in seeking to qualify under this statute since 1980 under the PURPA rules. About seven and a half million kilowatts of capacity have been applied for to qualify as QF's under PURPA. Now, that is the equivalent of seven or eight nuclear plants, so this baby is out there, and it is flourishing, and the states are adopting very many varieties of ways to implement the fully avoided cost system.

If the thing sours or goes bad somewhere, a state

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utility commission which is the natural representative of a consumer interest. The utilities are here rather piously telling us that they are interested in consumers, but it is historically the state utility commissions that have protected the consumer, and if they think this thing is ripping off the consumer, they are quite free to come in and get a waiver or suggest a change.

Your Honor, I have only three minutes to deal with my dazzingly complicated second issue which is the interconnection rule. The Court of Appeals here held that the rule requiring utilities to hook up, to make the physical interconnection necessary to accomplish purchase and sales under PURPA is invalid. Section 210 of PURPA requires utilities to hook in order to purchase and sell power, and the commission sensibly ruled that the only way to purchase and sell power was to make the physical interconnection so that you can do it.

The Court of Appeals said that the only way you can do this is to use the enormously complicated separate proceeding provided in Section 210 of the Federal Power Act to accomplish this.

The arguments on this issue where we think that the Court of Appeals misconstrued the two statutes and really issued a ruling threatening to cripple this experiment again I will leave to our brief and reply brief and would like to reserve the rest of my time for rebuttal.

CHIEF JUSTICE BERGER: Mr. Berlin?

ORAL ARGUMNET OF EDWARD BERLIN, ESQ.

ON BEHALF OF THE RESPONDENT

MR. BERLIN: Mr. Chief Justice, and may it please the Court:

I, too, will be dealing with the purchase rate rule. I suggest that if Congress wished to encourage every last drop of cogeneration, it would have legislated the 100-percent avoided cost rule. It did not do that because it wished the commission to inquire to search out whether it was possible consistent with the statutory objectives to share some element of the savings with the utility consumers. It did not intend for the commission to do what it did which was to automatically without that inquiry legislate the 100-percent rate which Congress itself certainly could have.

The commission failed to inquire. It rejected out of hand the percentage of avoided cost possibility on the speculation that it might not bring forth every last drop of cogeneration. It did not even consider the possibility of establishing such a percentage as a beginning rate allowing cogenerators to come in and seek more if that is insufficient in encouragement for them.

QUESTION: Mr. Berlin, why is it irrational for the commission to say that when we want to get this thing off the ground we do want to bring in every last drop of cogeneration because then we will know that the cogenerators are doing as well as they can, and then there will be time enough to adjust and see what proportion of those benefits are passed on to the consumers later after the cogenerators are in place?

MR. BERLIN: Justice Rehnquist, it undoubtedly is the case that a great deal of cogeneration that will be produced by the rule will be produced in response to the legislation and of the rule fairly immediately. In fact, there is a great flury of activity as Mr. Bator has indicated.

Under the commission's rules, cogenerators have an absolute right to a long-term contract. They do not have to rely on negotiations apart from the rule to get a long-term contract. Under the commission's rules they can get a long-term assurrance of a 100-percent rate.

I suggest that if the Congress shared the view that is assumed in your question, if it wished to encourage every last drop, it would have legislated a 100-percent rule.

QUESTION: What do you mean when you say they can get a long-term contract without negotiation?

MR. BERLIN: Under 304(d) of the commission's rules, a cogenerator at its option can in fact force a long-term commitment at 100 percent of avoided cost.

QUESTION: What would be the term as the rules say.

MR. BERLIN: We use the term, "To the discretion and option of the cogenerator." If the cogenerator is willing to commit capacity or energy for any term, then under that rule,

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the utility must accept it and must pay the full 100 percent of avoided cost rate.

QUESTION: Although that rate can vary from time to time as Mr. Bator indicated.

MR. BERLIN: That is certainly correct, and I think that shows the illogic in simply looking at the utilities' rate in establishing a rate that will be sufficient to encourage cogeneration. Indeed, even under a 100-percent rate, we have no way of knowing whether for any particular cogenerator that will be enough.

Congress realized that. That's why Congress put in the specific rate criteria in 210(b). It wanted the commission to exercise its judgment to make some inquiry, not an intrusive inquiry, but some inquiry nonetheless to make certain that it was providing enough, but not entirely excluding consumers if it was possible to permit consumers to share.

QUESTION: Mr. Berlin, I guess you agree, do you not, that the standard of review that should be applied in the Court is an abuse-of-discretion standard of review in determining whether the commission properly exercised it.

MR. BERLIN: Quite frankly, Justice O'Connor, I think that whether it is arbitrary or capricious, a substantial evidence need not be reached in this case because it is our contention that the agency simply failed to carry out the statutory criteria, failed to apply the statutory criteria.

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QUESTION: That's just dressing up the same argument another way.

MR. BERLIN: I think that is probably correct, and we would not dispute.

Now, I do note, although I don't think it is an issue in this case, that the Federal Power Act itself makes substantial evidence the review standard. That is not the issue in this case. The question is whether or not the agency has complied with the mandate imposed upon by the statute, and that is what we are arguing.

We are contending that they abused this discretion. They acted arbitrarily in failing to give meaning to the statutory criteria.

Mr. Bator says that -- and I was about to cite the Court to the reference in the commission's opinion where they say, "There will be no rate savings for consumers." Mr. Bator construes the commission's -- and the commission chose not to, but he construes it saying, "The commission really means there will be no immediate savings for consumers, but there will be," I assume he is implying, "long-term savings."

That is categorically wrong. There cannot be any rate savings for consumers in the immediate future or over the long term. The whole logic of the 100-percent avoided cost rule is that if a utility as a consequence of the availability of cogenerated power is able to reduce its own cost of generation,

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it must pay the full measure of that savings immediately, tomorrow, and in the future to the cogenerator. The utility's costs do not go down one cent. Its consumer rates cannot go down one cent.

QUESTION: Mr. Berlin, it does appear that adoption of the full avoided cost rule is simply the upper limit of what is permitted under the statute, so the commission appears to have acted within the framework of the statute but simply set the rate at the upper limits. Isn't it in fact a question of whether acting in that way is an abuse of discretion?

MR. BERLIN: I'm not sure that is the upper limit permitted by the statute, Justice O'Connor. The statute provides and the Government concedes this in its reply and it certainly made very clear in the conference report that the upper limit is either the rate produced by application of the 210(b) criteria or the utility's avoided cost whichever is the lower.

We suggest to you that Congress recognized that a just and reasonable rate might well be lower than the utility's avoided cost, and that's why it mandated the commission to inquire.

Now, the Government endeavors to substantiate the commission's rule by reasons similar --

QUESTION: Let me just ask one question --

MR. BERLIN: Yes, sir.

QUESTION: -- about what you are just talking about,

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Mr. Berlin. You say that there are no prospects in store of savings for consumers even down the road.

Does the commission's action of promulgating this particular rule negate the possibility that perhaps three or four years from now after it is satisfied that there are viable cogenerators in the field of changing the full avoided cost rule so as to pass on the savings?

MR. BERLIN: There is nothing to preclude the commission from changing its rule in the future, and should it change its rule and should it lower the rate below 100 percent, then there would be a possibility.

I was just simply pointing out that I think Mr. Bator is in error in suggesting that under a 100-percent rule there can be savings. There cannot be now or in the future.

Mr. Bator --

QUESTION: The commission didn't assume there would be savings, did it? Mr. Bator's argument was not disagreeing with that the commission said --

MR. BERLIN: Absolutely not.

QUESTION: -- in explanation of its own --

MR. BERLIN: Absolutely not. The commission --

QUESTION: It found public benefit because of the reduction in the use of coal and so forth.

MR. BERLIN: Not even that, Justice Stevens. The commission said first very clearly, "There will not be consumer

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savings."

QUESTION: Correct.

MR. BERLIN: Then it went on and said, "Commenters have pointed out, nonetheless, that there may be fuel savings," et cetera.

QUESTION: Well, that's obviously true, isn't it?

MR. BERLIN: That obviously is true --

QUESTION: Yes.

MR. BERLIN: -- and we don't dispute it.

QUESTION: And that's a public-interest factor.

MR. BERLIN: And there is question that it can take that into consideration.

Mr. Bator suggests that the alternative confronting the commission was either to establish a 100-percent generic rule or subject cogenerators to intrusive cost-of-service regulations.

We obviously agree that Congress did not intend to subject cogenerators to utility-type regulation, but look at the conference report that he cites in his brief, footnote 2, page 2 of the reply brief. "Congress clearly did not preclude any inquiry into cogenerator cost. It said, 'Make that inquiry in a less burdensome say.'"

In fact, it cannot be contended that the commission would be under a great burden if it undertook that responsibility. There is a companion rulemaking which you will find in the

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appendix to the petition. That companion rulemaking defined qualifying status -- those utilities that would qualify for purpose benfits. In undertaking that rulemaking, the commission said, "We must do a market penetration analysis. We must anticipate how much cogeneration would be brought forth by a 100-percent avoided cost rule."

As'it says on page B-139, "We begin our inquiry by looking at cogenerator costs." The commission in fact had a great deal of information available to it about cogenerator costs.

Mr. Bator also suggests, "So I say that when they are burdensome, there are ways available without subjecting them to adjudicatory case-by-case inquiry. Permian Basin is certainly a prime example of what could have been done."

Mr. Bator also suggests in his brief that we should give deference to the commission. It is a start-up rule. It was making predictive judgements. Again, he is putting words in the commission's mouth.

The commission never said that this is a start-up rule, that we are doing the best that we could in light of limited facts. In fact, the companion rulemaking shows that they had a great deal more information available to them.

The predictive judgment cases have never stood for the proposition that you excuse compliance with the requirements of the statute, that you validate a rule but fail to comply with the statutory prescription.

I would now like to turn --

QUESTION: May I ask, sir, what part of the statute did they not comply with?

MR. BERLIN: They made no effort at all, Justice Stevens, to look at any of the 210(b) criteria. 210(b) says that we should consider a rate that is dressed in reasonable --

QUESTION: By hypothesis this is just and reasonable because if they didn't buy the substitute power, they would still have a rate that the local utility said was just and reasonable.

MR. BERLIN: That, sir, is exactly what Congress knew and told us. If it wished to capture none of the savings for utility consumers, it would have prescribed and wished to maximize cogeneration, would have prescribed a 100-percent rule.

QUESTION: Congress could have said, "It must be there," but I think you said they have violated the statute by prescribing the statutory maximum. It seems to me that this is one of the alternatives the statute permits.

MR. BERLIN: Well, let me then correct that, Justice Stevens.

QUESTION: Yes.

MR. BERLIN: A 100 percent avoid cost rule is certainly permitted by the statute, and if I have given any contrary indication, let me retract it. I suggest, however, that before the commission can arrive at that 100-percent statutorily permitted rate, it must give deference to the criteria articulated by the statute. The commission never did that. It simply joined to the ceiling that Congress had established and said, "That is the just and reasonable rate."

Let me turn to interconnection issue if I can. The commission has directed that in every case in which a cogenerator wishes to ship power into a utility system, interconnection ought to take place automatically without the need to comply with the Federal authority.

We say that may not do, Justice Stevens, under the statute. The statute is clear on its face. Here we are dealing with two different section 210's. I hope I don't confuse it. We are dealing with Section 210 of the Federal Power Act which is an interconnection provision.

In PURPA Section 210 which has the rate provision in it, Congress authorized the commission to exempt cogenerators from certain provisions of the Power Act, but it said, "You may not exempt them from the interconnection provision of the Federal Power Act."

For Mr. Bator to prevail before you, he has two hurdles to overcome. He has to show the validity of his rule in light of 210(e)(3)(b), the non-exemption provision, and if he does, he must establish nontheless that there is implicit authority in PURPA to order interconnection.

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I suggest to you that the Government's argument really is illogical. The Government contends correctly that Congress knew all along that there must be interconnection authority, and then it goes on and says, "Congress confers this authority implicitly," though indeed the Congress did know that there had to be interconnection authority. It provided that interconnection authority in the Federal Power Act. That was the pattern followed from the very inception of the legislation. There was always a cogeneration rate provision and a companion interconnection provision which from the very first day included cogenerators, small power producers. Those little guys that Mr. Bator was talking about were always included in the Federal Power Act interconnection provision.

When the administration testified on the legislation, the Deputy Administrator of FEA, the Federal Energy Administration, said, "The interconnection provision of the Federal Power Act would be the vehicles by which cogenerators were getting to connections." He didn't suggest that there was implicit authority in the companion cogeneration provision.

Mr. Bator in his reply brief says, "We can forget about their testimony. That was addressed to the Administration's bill, not to the bill as enacted by the House, but there was no substantial difference in the respect that I am now talking about between those two bills.

More to the point, the testimony that the Government chooses not to deal with except in a footnote reference, that of the Chairman of the Federal Energy Regulatory Commission, Charles Curtis, was addressed to the House-passed bill, the bill that Mr. Bator says is relevant from a legislative-history purpose. That bill bears some consideration.

At that time, the House-passed bill contained two different interconnection provisions: the Federal Power Act interconnection provision with transmission facilities and the cogeneration interconnection provision allowing interconnection with distribution facilities.

What does Chairman Curtis, the chairman of the agency that is to administer the statute, say? He said to Congress, "You must pass the Federal Power Act interconnection provision because that will be the vehicle by which all cogenerators and small power producers, the little guys, get the ability to shift power into a utility system."

QUESTION: May I ask you one broad question? Under your view of the statute, would the commission have the power to adopt a rule that would give the authority to a local state commission to make the decision on whether a particular interconnection should be made?

MR. BERLIN: The commission could certainly under my view --

QUESTION: Under your view.

MR. BERLIN: And I totally advocate its responsibility.

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I think it may, Justice Stevens, have the capacity to delegate responsibility to state commissions in the overwhelming majority of the cases. I think it must, however, leave its door open a crack to allow someone who believes that a Federal interest is being violated, and the Federal interest here is an interest in the reliability of the interconnector transmission network to come before it and raise that reliability question.

QUESTION: As I read your brief, you seemed to say that Section 210 of the Power Act is the exclusive authority -- statutory authority -- for interconnection orders.

MR. BERLIN: With transmission facilities, yes, Your Honor.

QUESTION: And if that's true, then it would seem to me that that would require that the Federal Power Commission in Washington issue all those orders.

MR. BERLIN: That is correct, and let me respond to what I think lurks behind your question.

The Government certainly implies that if we prevail, we will be setting -- we will be requiring all of these thousands of small windmills that Mr. Bator very vividly talks about. He doesn't talk about the amicae in this case, the large paper companies and chemical companies and petroleum companies who will account for the overwhelming majority of cogeneration, but be that as it may, let's speak about his windmills.

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The statute certainly says that interconnection proceedings ought to be treated as adjudicatory proceedings. It references the APA sections.

To my mind, Justice Stevens, that shows that Congress was very concerned about these types of proceedings. It does now follow, however, that simply because these are adjudicatory proceedings that you must have thousands of proceedings before the FERC.

I am reminded of this Court's decision in Weinberger v. Heinsen, also an adjudicatory situation, where I believe Justice Rehnquist was writing for the Court, and he said that even in that situation when you use your rule-making authority to establish general rules, to establish congressional requirements, if Mr. Bator is correct that the overwhelming majority of interconnections will not present issues worthy of adjudicatory proceedings, then we submit that the commission can take care of that by using its rule-making authority by directing a threshold variable. What it may not do is to prevent a utility which believes it has the capacity to overcome that threshold showing from any opportunity to come before it.

I think my answer to your question --

QUESTION: What is the source of the rule-making authority you say is there? Is it 210(a) of PURPA?

MR. BERLIN: No, I think it's a general authority to issue rules and regulations under the Federal Power Act.

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I suggest that if you look at Chairman Curtis's testimony, if you recognize that he was addressing legislation which at that time said that cogenerators can obtain inter-connectors -- rather that distribution interconnections were available under the cogeneration provisions.

When you recognize that he said that was not going to be the vehicle because we are dealing with transmission facilities, please enact the Federal Power Act interconnection provision. That shows that the Government is flatly wrong in making the voltage-level distinction it tries to make between transmission and distribution facilities.

In fact, it is not a voltage-level distinction at all. It is a functional distinction. This Court has held facilities as low as 12 kilovolts in the City of Colton case to be transmission facilities. Conversely, it has held slightly larger facilities, 13.8 kilovolts to be distribution facilities in the Connecticut Light and Power case. Why is that?

The reason for that is that is not a voltage level distinction. It's a functional distinction. When power is being shipped to an ultimate consumer and it is going in one direction when a utility controls the flow of it, can protect its system, can protect its other customers, that is a distri-bution facility, but when someone who is not under the control of the utility unilaterally controlls the flow of power into a utility system, when it is a two-way flow, and that is what the commission's rules require -- it requires parallel operation -- then you are dealing with transmission facilities.

Congress recognized that. It recognized the transmission facilities present unique problems, and it dealt with those unique problems comprehensively in the 210 provisions.

Remember, in the 210 Federal Power Act provision, Congress included from the very inception cogenerators, small power producers, those little guys who were going to produce less than 80 megawatts. Congress included them because it recognized the potential for reliability problems, and it recognized that was a non-delegable Federal interest that FERC could not abdicate its responsibily.

Now, let me say a word about 210(e)(3)(b). Congress has just finished writing 210 of the Federal Power Act through all of the things that I have just described. Why did it put in 210(e)(3)(b)?

It put in 210(e)(3)(b) in conference at the same time it put in a savings clause in the Federal Power Act, 210(12)(e) and at the same time it put in the necessary-to-encourage language. Why do they do that? What's the logical explanation? What's the fair reading?

Well, the fair reading was that Congress simply did not want the commission to undo what it carefully crafted in the Federal Power Act interconnection provision, and that's why it put in 210(e)(3)(b).

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The Government in its reply brief repeats one argument that the commission had offered and then offers two new arguments that hadn't been made before.

First it contends that there is really a target applicant distinction, that 210(e)(3)(b) is intended to exempt cogenerators when they are targets, but you cannot exempt them from being targets for interconnection orders, and it points out that when you exempt somebody, you exempt them from an obligation, from a duty, from a burden.

QUESTION: We have heard about QF's and PURPA. What is a target?

MR. BERLIN: A target is the Government's invention for the justification of 210(e)(3)(b) which says that you cannot exempt QF's or cogenerators from the Federal Power Act interconnection provision. The commission says that what Congress was really saying there was you cannot exempt a cogenerator when it is the target of someone else's efforts to interconnect with it.

Under 210 of the Federal Power Act, a cogenerator can either apply for an interconnection or it can be the unwilling recipient of someone else's interconnection.

QUESTION: Sort of like a take over.

MR. BERLIN: Yes, and that's when they are a target. The problem is that 210 contains burdens when you are an applicant. Indeed, the whole purpose of putting 212 in the

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Federal Power Act is to impose burdens on those who are applicants for interconnection orders.

Secondly, the Government implies that cogenerators were included as targets for the first time in conference when (e)(3)(b) was added.

We suggest to you that does not appear to be the case. If you look at the House and Senate bills that preceded conference which the Government timely included as an appendix in the reply brief, you will see that they both reference the possibility that cogenerators could be targets of interconnection orders.

Finally, in a footnote to its reply brief, the Government contends that (e)(3)(b) talks about facilities. When discussing cogenerators as targets, they talk about them as facilities, and that, it implies, buttresses its target-applicant distinction.

I point out, however, that 210(e)(1) which is the provision which gives the commission the authority to exempt cogenerators from the Federal Power Act, from the Public Utility Holding Company Act, from state laws also talks about facilities. Carried to its logical extreme, it would mean that the barrier -- the barrier that Congress was determined to pull down, the barrier of regulations, would remain because under (e)(1) the commission could not relieve owners, operators. The Public Utility Holding Company Act is not addressed to

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facilities. It's addressed to the owners of those facilities.

All of the reporting requirements, all of the accounting requirements would remain if the Government's highly technical reading, admittedly in the footnote to its brief, was sustained.

Thank you very much, Mr. Chief Justice.

CHIEF JUSTICE BURGER: Do you have anything further, Mr. Bator?

ORAL ARGUMENT OF PAUL M. BATOR, ESQ.,

ON BEHALF OF THE PETITIONERS -- REBUTTAL

MR. BATOR: Yes, Chief Justice, just a few comments.

The question raised by Mr. Berlin about the legal obligation under the rules of the utilities to enter into the long-term arrangements, I would like to complicate it in a tricky reading of these rules.

We believe and the Government submits that it requires an enormous torture process to be done to the language to those rules to lead to the conclusion that the utilities have a long-term obligation or have an obligation to enter into long-term contracts with QF's.

The simple reading and the straightforward reading of the statute is that in the absence of using the PURPA system you simply -- each side is wholly free to bargain or not to bargain to a long-term contract.

On the long-term-saving question, Justice Stevens,

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on Mr. Berlin's account of this statute, it would be totally inexplicable. Why fix the utilities so they will be unable since the PURPA rate went into effect to obtain long-term contracts at less than fully avoided cost?

The reason that long-term saving will inure to the customer is the commission's rules explicitly provide that the availability of QF power as it comes into play should be taken in account, should be factored into the calculation of fully avoided cost.

QUESTION: I think I understand your argument, but I am not entirely sure the commission made that argument.

MR. BATOR: Well, they put it in the rule. Rule 292.304(e)(6) says to the states, "Factor it in." The commission did explicitly say the other thing which is that the existence of the PURPA rate would pit both parties into negotiation, and that is what it has done.

And that has already -- we don't even have to wait for the long term. Customers have already realized savings.

Finally, on this one, the commission explicitly made a relevant modest disavowal. They said, "This rulemaking presents an effort to evolve concept in a newly-developing area." That is not our invention. That's what the commission said.

Now, on the interconnection question, Mr. Berlin makes light of the obligations that would be imposed if every

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interconnection had to start with a Section 210 Power Act proceeding.

My only response to that, Your Honor, is to sit down and read Section 210 of the Power Act. It requires an absolutely full evidentiary hearing, a complete set of public-interest findings. Substantial evidence must support all of these findings. There is an absolutely overwhelming process.

The two statues, the Power Act and PURPA, are the product of an enormously complicated and untidy legislative process, and all I have time for is to beg the Court to understand that there were two very different things going on at the same time. The Power Act was dealing with a different range of problems, and it is really just sort of an unhappy coincidence that there is a kind of surface plausibility to injecting this totally inapposite Power Act proceeding into the middle of every PURPA interconnection.

It makes no sense. It makes absolutely no sense. For these reasons and the reasons stated in our brief, we ask that the judgment of the Court of Appeals be reversed.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 12:00 a.m., the case in the above-entitled matter was submitted.)

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#82-34 AMERICAN PAPER INSTITUTE, INC., Petitioner v. AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.; and

#82-226 FEDERAL ENERGY REGULATORY COMMISSION, Petitioner v. AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.

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