Issue Brief MPSC

Public Utility Regulatory Policies Act (PURPA)

1. What is the Public Utility Regulatory Policies Act (PURPA)?

PURPA is a federal law enacted in 1978 in reaction to the energy crisis and is implemented by state public service commissions for rate-regulated utilities. PURPA's goals are to encourage competition, conservation, reliability and efficiency in generating and delivering electricity. One of the ways PURPA was set up to accomplish its goals was by establishing a class of power generation facilities – known as qualifying facilities (QFs) – which would receive a special rate for selling their electricity to the local electric utility. PURPA imposed an obligation on local ("host") utilities to purchase power from QFs in an effort to promote competition and achieve other policy goals embodied in the federal law.

2. What is a Qualifying Facility?

Qualifying facilities are independent producers of power that fall into two categories:

- A small power production facility, whose primary energy source is hydro, wind, solar, biomass, waste, or geothermal resources.
- A cogeneration facility that sequentially produces electricity and another form of useful thermal energy (such as heat or steam) in a way that is more efficient than the separate production of both forms of energy.

Today, Michigan utilities are required to buy power generated by a QF smaller than 20 MW and are bound to compensate QFs based on the host utility's "avoided cost."

3. What is avoided cost?

"Avoided cost" is the amount an electric utility would pay to a QF in the utility's service area that is equal to the amount the utility would have to pay to generate the power itself or purchase from another source. In other words, the utility has avoided the cost of generating or buying the power itself.

4. Do avoided cost rates vary by utility?

Yes. Each utility in Michigan is unique geographically, financially, and operationally. When it comes to purchasing energy and ensuring sufficient energy supplies to meet customer demands, these differences drive different planning and procurement strategies. The avoided costs set for each host utility take into consideration these inherent differences and their impact on the avoided cost of energy.

5. What is the Michigan Public Service Commission's (MPSC) role?

Federal rules require state public service commissions to set rates at which the host utility will buy power from a QF. In the 1980s, the MPSC approved avoided cost rates which were the basis for contracts entered into between utility companies and QFs at that time. Most of these contracts were for terms longer than 20 years. Following the enactment of Public Act 341 of 2016, the MPSC is required to review avoided cost rates at least every five years.

6. How is avoided cost determined?

The Federal Energy Regulatory Commission (FERC) has provided state regulatory agencies a framework for setting fair and reasonable avoided costs in their jurisdictions. This framework describes the factors that may be considered in determining avoided cost and common avoided cost methodologies approved for rate setting. On a periodic basis, the MPSC will open a utility specific docket to revisit avoided cost rates. This docket will allow the host utility, staff, and intervenors (including impacted QFs) to provide evidence in support of future avoided cost rates to be paid to QFs. The MPSC will take this evidence into consideration in approving the new avoided cost rate for the host utility. This new rate will apply as directed by the MPSC in its order approving the rate.

7. Why is there debate over avoided cost?

Avoided cost determines how much the utility will pay the QF, and thus how much is passed along to customers. Utilities generally argue for a lower avoided cost which would reduce the amount of payments to QFs. Conversely, QFs argue for a higher avoided cost because they want to receive a higher payment from utilities. Actual avoided cost must reflect the costs that utility companies would otherwise pay for energy and capacity, giving QFs an opportunity to produce power and be compensated at the appropriate avoided cost rate.

8. What are the different components of an avoided cost rate?

Under PURPA, QFs have the right to sell electricity to utilities at avoided cost rates. There are two components for which a QF may receive the avoided cost rate – energy and capacity. Energy refers to the power generated, while capacity refers to the ability to generate electricity (e.g., power generation resources). Whether a utility has a capacity need or not, the QF is entitled to compensation at the avoided energy rate. The amount of the avoided capacity rate differs based on whether the utility has a capacity need. If a capacity need exists, capacity is valued at the utility's avoided cost of capacity. If no need exists, the capacity may be valued at zero or at the regional market's planning resource auction value for the host utility's region. The difference between an energy-only avoided cost rate and a full avoided cost rate which comprises both energy and capacity can be substantial, which means that there is usually a high level of interest when a determination of utility capacity needs is made.

9. What is a Standard Offer Tariff?

PURPA requires each utility to have standard rates for purchases from QFs with project design capacities of 100 kW or less. PURPA also allows, though does not require, utilities to set standard rates for purchases from QFs with project design capacities greater than 100 kW. A standard offer tariff makes it easier for small renewable energy generators to do business with the utility by standardizing contractual terms and conditions.

10. What are the current avoided cost rates?

For a breakout of current avoided cost rates by utility, please see the MPSC's Avoided Cost Fact Sheet.

11. Next steps:

The MPSC will be conducting new reviews of avoided cost rates for regulated utilities over the next two years. The MPSC is also working on updating interconnection rules, which govern how QFs connect to the utility system, as well as writing new rules defining when a legally enforceable obligation, or LEO, under PURPA has been established. Additional information on these rulemaking processes can be found on the MPSC website.

For more information, visit:
MPSC Website
Avoided Cost Fact Sheet

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