



10-1982

## American Paper Institute, Inc. v. American Electrical Power Service Corp.

Lewis F. Powell Jr.

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I apologize. I missed the listing of The American Paper Institute's Members. There are not member companies. You own stock in: Buckeye Cellulose, Chesapeake Corp., Nicolet Paper (aff. Philip Morris), Plainwell Paper (aff. Philip Morris), Procter & Gamble & Wisconsin Tissue Mills. RK

API is a  
TRADE ASSOCIATION

Case are important & Qs are close. But there is not the kind of case that requires action of our Court. The Fed. Energy Reg. Comm. has considerable flexibility

Preliminary Memo

October 8, 1982 Conference  
List 1, Sheet 2

No. 82-34

OK

AMERICAN  
PAPER  
INSTITUTE

v.

OK

AMERICAN  
ELECTRIC  
POWER  
SERVICE  
CORPORATION,  
et al.

Cert to CADC  
(Robinson,  
Wilkey  
& Ginsburg)  
Federal/Civil

Timely

no dissent

Deny both

No. 82-226

FEDERAL  
ENERGY  
REGULATORY  
COMMISSION

v.

OK

AMERICAN  
ELECTRIC  
POWER  
SERVICE  
CORPORATION,  
et al.

Cert to CADC  
(Robinson,  
Wilkey  
& Ginsburg)  
Federal/Civil

Timely

This seems a close case, at least with respect to INTERCONNECTION. However,



1. SUMMARY: Petr contends that the CADC erroneously vacated <sup>7</sup>two regulations it promulgated under §210(a) of the Public Utilities Regulatory Policies Act ("PURPA"), as inconsistent with other provisions of PURPA.

2. FACTS: The Federal Energy Regulatory Commission ("FERC") promulgated a number of rules under authority given it by §210(a) of PURPA to make rules it determined necessary to encourage cogeneration and small power production. Cogeneration is the simultaneous production of electricity and usable thermal energy, such as heat or steam. Small power production is the use of biomass, waste, geothermal, or renewable resources to produce electric power. <sup>✓</sup>Two of these regulations promulgated under §210(a) of PURPA are at issue in this case. The first, §292.304(b), particularly subsections (2) and (4), relate to the price at which utilities must purchase electricity from cogeneration facilities and small power production facilities. For ease of reference, such facilities will be referred to as qualifying facilities. Section 292.304(b)(2) and (4), termed the "full avoided cost rule," provides that a utility must purchase electricity from qualifying facilities at a rate that equals that utility's full avoided cost. <sup>§</sup>Full avoided cost is simply a synonym for the marginal cost a utility would incur if it obtained electricity from another source, such as by increased production of power at its own facility.

The second rule under attack, §292.303(c)(1), provides that "any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases

[from] and sales [to]" qualifying utilities. An interconnection is a physical connection that permits electricity to flow from one utility to another. This rule has been termed the "interconnection rule."

These regulations have been challenged by resp as inconsistent with certain provisions of PURPA and the Federal Power Act ("FPA"). Specifically, the avoided cost rule is said to conflict with §210(b) of PURPA. Section 210(b) of PURPA provides:

"(b) RATES FOR PURCHASES BY ELECTRIC UTILITIES

"The rules prescribed [by FERC] . . . shall ensure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purpose--

"(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

"(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

"No such rule prescribed . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy."

The interconnection rule is said to undermine §§210 and 212 of the FPA, and thus conflict with §210(e)(3), which expressly provides that qualifying facilities may not be exempted from §§210-212 of the FPA. Section 210 of the FPA gives FERC the power to order interconnection and make any ancillary orders necessary to make interconnection effective. Subsection (a) provides that such orders may be entered upon the application of any utility or qualifying facility. Subsection (b) provides that



before making such an order FERC issue notice to all affected parties and provide an opportunity for an evidentiary hearing. Subsection (c) provides that FERC is only to issue the requested order if such an order is in the public interest, would either encourage overall conservation of energy capital, optimize the efficient use of facilities or resources, or improve the reliability of any electric utility to which it applies, and meets the requirements of §212. Subsection (d) gives FERC the power to initiate such a proceeding on its own motion. Section 212 provides that FERC shall not issue an order under §210, unless it determines that such order will not lead to four specified harms to the producer of power forced to interconnect or its customers.

FERC's justification for the rules was provided in FERC Order No. 69 and its order granting in part and denying in part rehearing on Orders 69 and 70. FERC noted that it had initially proposed that there be a rebuttable presumption that the rate at which utilities purchased power from qualifying facilities was acceptable if it reflected full avoided cost. Because it received comments that the rule was ambiguous, explained FERC, it settled upon the challenged rule. FERC then addressed a number of comments, including comments of utilities that they and their ratepayers would be subject to increasing costs of world energy if the rate they had to pay for power from qualified facilities was set at full avoided cost. In response to arguments pro and con, FERC said:

"The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies." Petn. at B-65.

FERC explained that another problem of attempting to split between qualifying facilities and electricity consumers the difference between the qualifying facilities costs and that of alternate sources of energy was that it would have to determine the costs of qualifying facilities. "A major portion of [PURPA]," it explained, "is intended to exempt qualifying facilities from cost-of-service regulation by which utilities traditionally have been regulated."

✓ FERC responded in its rehearing order to the argument that its interconnection rule contravened §210(e)(3) of PURPA. FERC noted that §§210 and 212 grant the right to apply for interconnection orders, but also impose an obligation or liability of being subjected to such orders. Section 210(e)(3) was meant to prevent FERC from relieving qualifying facilities from the liabilities of §§210 and 212, it did not make the sections the exclusive vehicle for the exercise of the privilege of forcing interconnection. Such an interpretation is consistent with the accepted meaning of "exempt" -- "to release or deliver from some liability or requirement to which others are subject." The privilege of forcing interconnection is not a liability or a requirement, while the amenability to an interconnection order is



such a liability or requirement. FERC cited no legislative history for this proposition.

3. DECISION BELOW: The CADC vacated both of the regulations. It first discussed the "full avoided cost" rule. The court began its discussion by saying that it was holding that "FERC had not adequately justified its adoption of the full avoided cost standard." It noted, quoting a passage from the Conference Report on PURPA, that the limitation of the price which utilities could be forced to pay to the utilities' marginal cost was not meant to supercede the "just and reasonable" standard for determining price. It then rejected FERC's three reasons for the full avoided cost rule. The court said that FERC had provided no factual basis for the claim that any lowering of price to utilities would lead to insignificant rate reductions to utility customers. FERC's desire to avoid rate setting on the basis of the qualifying facility's costs could have been served by setting the price at some percentage of avoidable cost. Finally, FERC justified its rule by saying that if the price were set at some percentage of avoidable cost the price would be insufficient to induce potential qualifying facilities to begin production. The court said, however, that "FERC should allocate the benefits more evenly between [qualifying facilities] and utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the [qualifying facility] is in the public interest and the interest of utilities' electric consumers, and will not disproportionately discourage [the production from qualifying

facilities].” The court then set out some concerns that FERC should consider on remand. First, full avoided cost might not be in the public interest because cogeneration and small production facilities whose cost equal that of utilities may produce more detrimental effects in such forms as more pollution or less tax revenues. Moreover, by reducing the number of kilowatt hours over which utilities can spread their fixed costs, increased sales of power by qualifying facilities may raise the per kilowatt the price of utility-produced power. The court then explained that if competitive forces existed in the market for cogeneration and non-fossil-fuel based power, FERC should take such forces into account in determining the degree and type of regulation necessary. If the market for such power is not competitive, said the court, FERC may be justified in its current regulation of the rates charged by utilities. Even then, however, it would not be clear that full avoided cost is the proper rate level.

With respect to the <sup>11</sup> interconnection rule, the court also rejected FERC's arguments. First, it concluded, contrary to FERC's suggestion, that forcing qualifying facilities to go through adversary hearings before being able to force interconnection would impose an undue burden on such facilities. FERC, the court concluded, could adopt streamlined procedures for making the necessary findings under §§210 and 212, and thus relieve qualifying facilities from the present burdens of the hearing process. It dealt with the argument FERC presented in the rehearing order as follows:



"Finally, FERC argues that rule 292.303(c)(1) is consistent with PURPA section 210(e)(3) if the latter is interpreted as protecting cogenerators who are targets of other parties seeking interconnection, and not extended to situations where the cogenerator is an applicant for an interconnection itself. While an interesting and not inherently implausible suggestion, the Commission points to no evidence in the legislative history or the statute itself to justify this interpretation, which is both counterintuitive and inconsistent with the statute's explicit provisions. Nor were we able to find such evidence. Accordingly, we reject the interpretation. The Commission's interconnection rule is hereby vacated." Petn. at B-24 to B-25 (emphasis in original).

✓FERC petitioned for rehearing. Only five CADRC judges participated in the decision, two of the five dissented from the denial of rehearing en banc. The ✓dissenters said that, as they read FERC's orders, FERC had found that the interests set out in §210(b) of PURPA could best be accommodated by a rate that would encourage cogeneration without raising rates to consumers. They said this determination seemed reasonable, and they expressed doubt as to whether any further explanation was necessary to satisfy the requirements of the Administrative Procedure Act, 5 U.S.C. §706(2)(A). With respect to the interconnection rule, the dissenters said that in rejecting the rule the panel:

"has rejected FERC's alternative interpretation of the statute that would simply prevent the Commission from requiring a cogenerator to interconnect without providing for an evidentiary hearing. The alternative interpretation is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration. This alternative reading should receive closer scrutiny by this court before it erects a formidable, perhaps insurmountable, roadblock to a major energy program." Petn. at B-208.



*Attacker CADC's  
holding.*

4. CONTENTIONS: The SG. With respect to the interconnection rule, the SG reasserts the argument that FERC presented in its rehearing order. The SG also argues that the decision below frustrates two of Congress' desires. First, the decision below will undermine Congress' attempt to encourage cogeneration and small power production, by requiring a full-scale administrative adjudication before a utility could be compelled to purchase electricity from a qualifying utility. Secondly, by requiring a proceeding before FERC, and thus rendering invalid FERC rules leaving the resolution of conflicts over interconnection to state authorities, the CADC has frustrated Congress' desire to leave the detailed case-by-case oversight of interconnections to state authorities.

With respect to the full avoided cost rule, while the CADC claimed to hold only that FERC had offered insufficient justification for the rule, the CADC's decision indicates that such a rule cannot be adopted regardless of the justification that FERC proffers for it. In any event, since the rate set by FERC was within the zone of reasonableness, as defined by Congress when it provided that the price qualifying facilities could charge could not be set above the utility's marginal cost, the CADC lacked authority to vacate the rate. Permian Basis Rate Cases, 390 U.S. 747, 767 (1968). The CADC mischaracterized FERC's rule, since even under the rule many utilities may not have to pay full avoided cost when the utility purchases power from a qualifying utility. Any state may apply for a waiver of FERC's rule, and qualifying facilities and utilities may



negotiate prices that are lower than the full avoided costs. The CADC also erred in outlining a host of concerns to be examined on remand, for by doing so the CADC substituted its judgment for that of FERC. Indeed, the CADC seemed to apply a "substantial evidence" test, rather than an "arbitrary and capricious" test, when reviewing the two FERC regulations. Finally, because many states have adopted regulations in reliance on the "full avoided cost rule," and because some rule is necessary so that new qualifying facilities will be certain enough of the price they can obtain to make investments and obtain capital, the benefits Congress sought to achieve by PURPA may never be realized if the decision below is not reversed.

✓ American Paper Institute ("API") (Intervenor Below). The vacatur of the interconnection rule will have a devastating impact on the cogeneration and small power production industries. Qualifying facilities cannot find a market for their power unless they can promptly obtain interconnections. Cogenerators and small power producers, faced with the obstacle of having to fight utilities in an adversary context (in which the utilities have a wealth of experience and numerous opportunities for delay) before they can obtain needed interconnections, will simply not go forward with production. Such a result would undercut the policies underlying PURPA. Moreover, by rejecting FERC's conclusion that §210(e)(3) only subjected qualifying utilities interconnection orders, the court rejected a reasonable interpretation of §210(e)(3). The court thus ignored the rule that an agency interpretation of a statute should be honored if

it is not clearly wrong. The maxim carries special weight when the challenged interpretation is a contemporaneous construction of new legislation.

The vacatur of the full avoided cost rule will also have a devastating impact. Owners of potential qualifying facilities cannot make any of the decisions they need to make to begin or continue production because they have no way of estimating the revenue streams that their projects can be expected to generate. The uncertainty cast upon this important federal program by the decision below makes this case a particularly compelling one for review by this Court. (API then repeats the argument in the SG's brief that the FERC rule was examined under too exacting a standard of review.)

Respondent. The vacatur of the full avoided cost rule does not merit review. The court simply said that the adoption of the rule was ill-considered, and indeed "the Court of Appeals exercised circumspection and restraint, finding that the Commission appears not to have adhered to the statutory commands, but giving it the opportunity to adopt the same rule on remand if it can present a cogent justification of its rule in light of statutory instructions." The decision below was right. The rate set was not "just and reasonable." The "just and reasonable" standard requires a balancing of the interest of the parties. By setting a maximum, Congress did not intend to set a zone of reasonableness. The argument that the actual rates may be lower than the rates set by FERC is a post hoc rationalization of the rate FERC adopted. Moreover, the state's ability to request



waiver of FERC regulations does not really help the customers of the utility, since they cannot initiate such a request, and the fact that qualified facilities may not demand the full rate to which they are entitled cannot save an unreasonable and unjust rate. Finally, any uncertainty or delay occasioned by the rule below is unfortunate, but they are the result of FERC's failure to promulgate a lawful rule in a timely manner.

The vacatur of the interconnection rule presents no certworthy issue. The court below found that the rule violated the plain meaning of the statute. The argument that the CADC's interpretation of the statute frustrates congressional purposes is mistaken for two reasons. First, it ignores the powerful federal interest, furthered by §§210 and 212 of the FPA, in assuring that interconnections are safe and reliable. Second, it makes statutory hearing procedures seem onerous when such procedures could, given FERC's powers to restrict the opportunity for a hearing to those cases in which a party meets the threshold requirements established by an agency, be simple and unburdensome.

Resp Elizabethtown Gas Co. Elizabethtown Gas Co. supports the petition, but adds nothing new.

5. DISCUSSION: The<sup>✓</sup> validity of the "interconnection rule" seems certworthy. FERC's interpretation of §210(e)(3) of PURPA as permitting interconnection orders in the absence of a hearing and the determinations required by §§210 and 212 of the FPA seems reasonable. The<sup>✓</sup> CADC decision requiring some FERC determination under §§210 and 212 of the FPA may well make it difficult for

qualified utilities to obtain interconnection with utilities. Such a ruling might make obtaining interconnection difficult for cogenerators and small power producers, and reestablish the bottleneck Congress tried to break by passing PURPA. (It is possible, however, that FERC could break this bottleneck by adopting streamlined procedures.) *Yes*

The vacatur of the full avoidable cost rule is probably not worthy of cert. The CADC has not conclusively said that such a rule cannot be adopted. Moreover, even if ultimately FERC will only be able to promulgate a rule that allows the rate to a qualifying utility to range between 80% to 100% of avoidable cost (a possible rule suggested by the CADC panel), the policies Congress sought to further by passing PURPA will probably not be gravely damaged. I do note, however, that the CADC's decision does make it difficult for FERC to justify a full avoidable cost rule, and thus if such a rule is indeed crucial to the success of PURPA the vacatur of the full avoidable cost rule should probably be reviewed.

I recommend a grant limited to the validity of the vacatur of the interconnection rule.

There is a response covering Nos. 82-226 and 82-34 in No. 82-226. There is an additional response in No. 82-34.

September 28, 1982

Bell

Opinion in  
Appendix  
to Petition  
in No. 82-34

ME



Preliminary Memo

October 8, 1982 Conference  
List 1, Sheet 2

No. 82-226

FEDERAL  
ENERGY  
REGULATORY  
COMMISSION

Timely

v.

AMERICAN  
ELECTRIC  
POWER  
SERVICE  
CORPORATION,  
et al.

Cert to CADC  
(Robinson,  
Wilkey  
& Ginsburg)  
Federal/Civil

Please see Preliminary Memo in No. 82-34, American Paper  
Institute, Inc. v. American Electric Power Service Corporation,  
et al., October 8, 1982 Conference (List 1, Sheet 2).

There is a response.

September 28, 1982

Bell

Opinion  
in Appendix  
to Petition  
in No. 82-34

ME

if doesn't seem that the CAD's ~~off base that cost should be granted~~  
READING IS UNREASONABLE. Given, the  
state of the docket I am inclined to  
recommend denying cost.

RK

EXHIBIT 1000

October 8, 1983 Conference  
List 1, Sheet 2

NO. 83-12

GENERAL  
COUNSEL  
REGULATORY  
COMMISSION

OFFICE OF THE  
ATTORNEY GENERAL  
FEDERAL CIVIL  
DIVISION

AMERICAN  
ELECTRIC  
POWER  
SERVICE  
CORPORATION  
et al.

Please see preliminary memo in NO. 83-12, American Electric

Power Service Corporation, Inc. v. American Electric Power Service Corporation.

et al., October 8, 1983 Conference (List 1, Sheet 2).

There is a response.

Exhibit  
in Appendix  
to Petition  
in NO. 83-12

NO. 11

September 28, 1983



No. 82-226

AM. ELEC. POWER

Graded  
+  
Consolidated

[illegible]

Court .....  
 Argued ....., 19...  
 Submitted ....., 19...

Voted on ....., 19...  
 Assigned ....., 19...  
 Announced ....., 19...

82-34

No.

AM. PAPER INSTITUTE

vs.

AM. ELEC. POWER

*B.R.W. same  
 case in dead  
 wrong.*

*I am not at  
 rest & also want  
 to check membership  
 in Petri. There is the  
 Association of the  
 Paper Industries - but  
 we normally don't disqualify  
 on basis of members of a  
 trade assn.*

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
		G	D	N	POST	DIS	AFF	REV	AFF	G	D		
Burger, Ch. J.		✓											
Brennan, J.		✓											
White, J.		✓											
Marshall, J.		✓											
Blackmun, J.		✓											
Powell, J.													
Rehnquist, J.		✓											
Stevens, J.		✓											
O'Connor, J.													

*in both*

*both*

*but grant 2nd case*

*Pass*

*in both*

*both*

*Out*



drk 10/13/82

To: Mr. Justice Powell

From: Rives

Re: Disqualification When a Trade Association is a Party

Canon 3C(1)(c) of the Code of Judicial Ethics provides that a judge should disqualify himself when his impartiality might be questioned because "he knows that ... he has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding." Advisory Opinion No. 49 addresses the question of whether a judge's financial interest in a member of a trade association requires disqualification. It adopts the position advanced by Professor Thode in his Notes to the ABA Code of Judicial Conduct and distinguishes between direct financial ownership and indirect or technical ownership. It determines that owning stock in a member of a trade association, like owning a policy in a mutual insurance company, is an indirect financial interest that does not require disqualification.

The Opinion concludes:

Accordingly, the Committee sees no impropriety in a judge serving in a proceeding where a trade association appears as a party, even though the judge owns a small percentage of the publicly-traded shares of one or more members of the association, subject, of course, to the general qualifications set forth in sections 3C(1)(c) and 3C(3)(c) of the Code of Judicial Conduct.

Advisory Opinion 49 was reaffirmed in Advisory Opinion 62. Opinion No. 62 is not dated but follows, obviously, opinion No. 61, which is dated April 16, 1979.

There is a minor difference between the introductory section of the statute and that of the Code. It is, however, immaterial.



The Opinion expressly qualifies its approval by referring to sections 3C(1)(c) and 3C(3)(c), which provide for disqualification when a judge has any interest that could be substantially affected by the proceedings. It would seem that if a ruling had the possibility of materially affecting the economic health of an industry represented by a trade association, an interest in a member of the industry might require disqualification.

A review of the cases under 28 U.S.C. §455 indicates that no court has decided the question of whether owning stock in a member of a trade association requires disqualification.

Keep in File ✓

Supreme Court of the United States  
Washington, D. C. 20543

CHAMBERS OF  
JUSTICE SANDRA DAY O'CONNOR

October 14, 1982

No. 82-34 American Paper Institute v. American  
Electric Power Service Corp.  
No. 82-226 FERC v. American Electric Power  
Service Corp.

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Dear Chief,

Based on Lewis' memo of October 14 and the opinion of the Advisory Committee on Judicial Activities concerning stock ownership in a member of a trade association when only the trade association is a party, I plan to participate in the referenced cases. You may disregard my previous expression of recusal.

Sincerely,

*Sandra*

The Chief Justice

cc: Justice Powell  
Alexander L. Stevas



October 14, 1982

82-34 American Paper Institute v. American Electric Power

MEMORANDUM TO THE CONFERENCE:

This refers to our discussion last Friday as to disqualification where one owns stock in a company that is a member of a trade association where only the trade association is a party.

This question has been answered by the Advisory Committee on Judicial Activities. I enclose a copy of its Opinion No. 49 dated June 9, 1977. This was reaffirmed in Opinion No. 62 in 1979.

Although these opinions refer to provisions of the Code of Judicial Conduct, the federal statute, 28 U.S.C. §455, tracks the Code in the relevant language.

The petitioner in this case, American Paper Institute, is said to have 164 members. Our family and trusts own stock in one of the listed members. Two other companies in which we have an interest have "affiliates" or subsidiaries listed among the members of the petitioner. I personally represented the two parent corporations and would remain out if their subsidiaries were parties without regard to stock interest.

I have not heretofore recused simply because of interest in a member of a trade association where only the association is the party. I suppose there are situations where the case is of such considerable importance to an entire industry that arguably its outcome could have some effect even on one's ownership of a small fractional interest in a company's listed and publicly traded shares.

I think the ruling of the Advisory Committee is correct, as it is unlikely there was any intent to extend "recusal" this far. A judge's ownership in a mutual or "common investment fund" presents a stronger case for recusal, and it is expressly excepted in Canon 3C(3)(c).

L.F.P., Jr.

March 11, 1983

82-34 American Paper Institute v. American  
Electric Power Service Corp.  
82-226 FERC v. American Electric Power Service Corp.

Dear Chief:

It now appears necessary for me to remain out of the above cases.

Petitioner's brief, filed December 2 and that I looked at this morning for the first time, is signed by counsel for several companies, including a company in which Jo and a trust for her benefit hold stock.

When we considered certiorari on these cases, I mentioned at Conference the fact that among the 164 members of the American Paper Institute (a trade association) were a couple of former clients in which we also held stock. There are opinions of the Ethics Committee to the effect that this would not require disqualification. See my letter to the Conference of October 14. Although I passed at the Conference, I then thought I was free to participate.

The counsel whose name now appears on the brief for petitioner was not listed as counsel on the petition for certiorari.

Sincerely,

The Chief Justice

lfp/ss

cc: The Conference