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MEMORANDUM

DATE: April 16, 1992

TO: Lee Sparling
Manager
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Public Utility Commission

FROM: Paul A. Graham PAG
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Public Utility Section

SUBJECT: Commission Authority to Consider External Environmental Costs

You ask for our opinion on several questions which surround the Commission's authority to consider external environmental costs. Your questions arise out of a current investigation before the Commission designated as "UM 424." The Commission, in their generic least-cost planning order, required utilities to "consider external costs" in their least-cost plans. See Order No. 89-507. In UM 424, the Commission staff recommends specific guidelines for the treatment of external costs in least-cost plans and in other resource decisions. You raise a basic question concerning the parameters of the Commission's statutory authority to consider external environmental costs in utility least-cost planning. Depending upon our answer to this basic question, you ask for our advice on the standards to use should the Commission use external costs in a ratemaking decision. You also ask whether the Commission's authority to consider external costs in least-cost planning is preempted by either the commerce clause of the Constitution or the federal Clean Air Act.

For the following reasons, we conclude that the Commission has authority to consider external environmental costs in a utility's least-cost plan. However, the Commission lacks statutory authority to directly or indirectly require a utility

to make a resource acquisition or a resource dispatch decision based upon a total resource cost which includes external costs.

Our answer to the question of the Commission's authority vitiates the remaining preemption questions. However, in order to give further guidance, we conclude that, should the Commission obtain the requisite statutory authority, the federal Clean Air Act would not preempt the Commission's use of air pollution external costs in evaluating energy resource and dispatch decisions.

Finally, assuming the proper grant of authority, we find that we are unable to decide the commerce clause issue because there are not sufficient facts in this record to adequately address it.

DISCUSSION

1. Commission Has Authority to Consider External Costs But Lacks Authority To Impose External Costs on Utilities.

An "external cost" may be defined in several ways. In Commission Order No. 89-507, the generic least-cost planning order, Commissioner Katz succinctly noted that an external cost is one that is "borne by others" and an internal cost is one that is "borne by utilities." Order No. 89-507, p. 13 (concurring opinion). Similarly, the Massachusetts Department of Utilities defines environmental externalities as "the costs associated with damages caused by a project for which compensation to the affected parties does not occur." Re Integrated Resource Management Practices, 116 PUR 4th 67, 90 (1991). These definitions encompass the notion that an external cost, in the utility regulation context, is a cost that the utility is not legally required to bear.

This is not to say that an external cost is not a "true" cost. Clearly, residual sulfur dioxide emissions cause environmental degradation.

The Commission has been delegated broad powers by the legislature to supervise and regulate utilities and to obtain for their customers adequate service at fair and reasonable rates. ORS 756.040(1), (2). In construing this power, the courts have held that the Commission's authority is potentially as broad as the legislature's. See Pacific Northwest Bell v. Sabin, 21 Or App 200, 213 (1975). However, it is clear that the Commission is not on an equal standing with the legislature. The Commission may only do what it has been enabled by statute to do. See,

e.g., Pacific Northwest Bell v. Davis, 43 Or App 999, rev den 289 Or 107 (1980).

The legislature has not granted the Commission express authority to assign external costs to a utility. While ORS 756.040 grants broad powers to the Commission, we are concerned by the absence of clear statutory authority for the Commission to require a utility to bear external environmental costs. Simply stated, the Commission lacks the authority to require, directly or indirectly, that a utility reduce its air emissions below legally mandated standards.[1/]

In reaching this conclusion, we considered the direction provided by ORS 469.010(2)(f) which states:

> "(2) It is the goal of Oregon to promote the efficient use of energy resources and to develop permanently sustainable energy resources. The need exists for comprehensive state leadership in energy production, distribution and utilization. It is, therefore, the policy of Oregon:
>
> "* * * * *
>
> "(f) That cost-effectiveness be considered in state agency decision-making relating to energy sources, facilities or conservation, and that cost-effectiveness be considered in all agency decision-making relating to energy facilities." (Emphasis added.)

We also reviewed ORS 469.020(3)(e) which defines "cost-effective" as follows

> "(3) 'Cost-effective' means that an energy resource, facility or conservation measure during its life cycle results in delivered power costs to the ultimate consumer no greater than the comparable incremental cost of the least cost alternative new energy resource, facility or conservation measure. Cost comparison under this definition shall include but not be limited to:
>
> "* * * * *
>
> "(e) Environmental impact."

Neither statute, considered separately or together, grants the Commission the power to require that a utility reduce its air

emissions below the standards set by other federal or state agencies. We initially observe that ORS 469.010(2)(f) is merely a policy statement and not a statute that independently empowers the Commission. See Anderson v. Peden, 284 Or 313 (1978). Similarly, ORS 469.020(3)(e) is a definition, not a grant of power.

ORS 469.010(2)(f) allows the Commission to "consider" environmental costs. "Consideration" is the phrase used in the Commission's generic least-cost planning order: external costs are to be "considered" in the development of a plan by each utility. Order No. 89-507, p. 10. Within limits, this is a valid requirement.

The Commission may "consider" external costs by requiring a utility to anticipate external costs that may be internalized in the future and to include such costs in their least-cost plans. For example, if it appears that a federal or state law may be adopted mandating stricter air emission limits, the utility may include in its least-cost plan the cost of whatever measures may be necessary to achieve compliance with this future requirement.

Similarly, the Commission may "consider" external costs by allowing a utility to recover the cost incurred for pollution controls it installs voluntarily or by allowing cost recovery for acquisition or dispatch of a higher cost but lower-polluting resource. For example, a utility's consideration of external environmental costs in its least-cost plan may cause it to choose a resource that has higher costs when measured without inclusion of the external costs. A coal-fired electrical generation plant may be a lower cost resource, without consideration of environmental costs, than a solar-powered generation plant. Nevertheless, the Commission may allow cost recovery for the higher cost solar-powered plant by taking into consideration its lower impact on the environment.

However, as stated, external costs are defined as those costs that the utility is not legally required to bear. The Commission is not empowered under its current enabling statutes to impose external costs upon utilities.

Because we conclude that the Commission does not have authority to require utilities to incorporate external costs that will not likely become internal costs or that the utility does not voluntarily choose to internalize as described above, we do not answer your questions concerning standards to apply for excluding utility investment and costs from rates for failure to make resource acquisition and dispatch decisions based on external environmental costs. It would be more appropriate and

useful to answer such questions in the context of pending or adopted legislation delegating the necessary authority to the Commission as discussed.

2. Clean Air Act Would Not Prevent Commission From Using External Costs.

Our conclusion that the Commission lacks authority to impose or impute external costs in utility resource acquisition and dispatch decisions moots the remaining preemption questions. However, we will briefly discuss the preemption issues presented because we do not believe that the legislature is preempted from adopting a statute granting the Commission such power.

The federal Clean Air Act (CAA), 42 USC § 7401 et. seq., delineates a regulatory scheme designed to control air pollution. The CAA directs the Environmental Protection Agency to adopt national air quality standards at a level adequate to protect the public health. 42 USC §§ 7409(a), (b).

Each state is required to adopt an implementation plan of its own. 42 USC § 7410(a). Importantly, the CAA established only minimum air quality levels and states are free to adopt more stringent protections. 42 USC § 7416. Thus, the CAA clearly does not preempt the state or its agencies from adopting regulations that are more restrictive than the federal Act.

We have reviewed the argument presented by one of the utilities that because the Commission has not been designated by the state legislature as the "implementing agency" for the CAA, the Commission is somehow foreclosed from considering external costs in the utility regulation arena. See PGE Br. at 8-12. We are not persuaded by this argument.

The Commission, assuming it has been delegated authority to impute external costs, would not be "enforcing" the CAA. Rather, the Commission would be fulfilling its own newly created statutory mandate to ensure that external costs are included in resource acquisition and dispatch decisions. The CAA would not impede or usurp a grant of authority to the Commission to assign external costs in the utility regulatory context.

3. Commerce Clause Is A Fact-Specific Inquiry; There Are Not Sufficient Facts to Address This Issue In UM 424.

Article I, Section 8, clause 3 of the U.S. Constitution vests in the federal government the power "to regulate commerce * * * among the several states." The usual commerce clause test

is set forth in Pike v. Bruce Church, Inc., 397 US 137, 142 (1970):

> "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."

When the state law involves matters of local concern and its impact on interstate commerce is minimal, the law is generally upheld against a commerce clause challenge. Burlington Northern Railroad Co. v. Dept. of Public Service, 763 F2d 1106, 1114 (9th Cir 1985).

In this docket, we do not have the state law to review because it has not been enacted. Nor do we have a full airing of the alleged burden such a law, as implemented by the Commission, would impose upon the utilities. Thus, it would be premature and of little value to render an opinion as to the ability of the future law to withstand a commerce clause challenge.

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[1/] We say that a utility bears external environmental costs directly if the utility and/or its ratepayers are required to pay some or all of the external costs of the utility's resources. A utility bears these costs indirectly if it chooses a cleaner resource with higher internal costs or if the Commission disallows a portion of the cost of a resource because of its higher external (and total) cost. In UM 424, the Commission staff's guidelines impose external costs indirectly.

CERTIFICATE OF SERVICE

I certify that on April 16, 1992, I served the foregoing MEMO TO LEE SPARLING upon the parties hereto by mailing, regular mail, postage prepaid, a true, exact and full copy thereof to:

SEE ATTACHED LIST

Michael T. Weirich, #82425
Assistant Attorney General
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