Contracts in Wonderland: A Fable Regarding the Administrative Adjudication of Qualifying Facility Contracts in California

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I. THE FABLE

This fable is about promises. It takes place in a principality where, once upon a time, making promises — and keeping them — was very important. A place where long-settled rules about the process of making sure promises are kept are now disregarded by many parties. A place where it may no longer be clear what those rules are. It is a rather small story within a very large story. The small story cannot be fully understood, however, without knowing the larger story. Therefore, that is where we shall begin.

A. The First Story

Once upon a time there was a mighty country, which some believed was the most powerful on earth, whose might was imperiled by an oversight. That oversight was a dependence that many of its great industries and citizens had developed on a magical substance extracted from deep within the earth. This substance fueled the large engines of industry, the source of the country's wealth, as well as the little engines that provided the means of heating, cooling, lighting, and transporting the many citizens of the country.

Although the magical substance was abundant, more so in some forms than others, the increasing consumption presented challenges to those dedicated to locating, extracting, and producing the necessary supply. It just so happened that the country could not produce enough to match its own consumption and had to import the difference from other countries. Those countries possessed much more of the magical substance than they consumed. Unfortunately, those countries developed collective differences with the rulers of the great country, and decided to increase the price of the magical substance. When this did not get the attention of the rulers of the great *country, they decided to withhold the supply entirely. Maybe, just maybe, this would finally get them the attention they wanted.*

It did. Now everyone, rulers and citizens alike, wanted to talk about the magical substance, the lessened supply, and its consequences. But since it took so long to explain all these events every time someone wanted to talk about it, and it really was more complicated than explained here, and just about everyone had a different version of the events, it was difficult to get through a description of it all, much less talk about the consequences. More often than not, the moon would go through its phases many times before rulers and citizens even got close to agreeing on the relevant sequence of events that led to the situation — much less what the problem was. Some said it was a foreign policy problem. Others said it was a foreign trade problem. Others said it was a domestic commercial problem. Others said it was a general supply problem. Others said it was a specific consumption problem. Yet others said it was a security problem. Needless to say, some said it was all of the above.

Eventually, it was decided to circumvent such arguments by forgoing agreement on the causal events and determination of the problem and focusing instead on its effects. This was a significant breakthrough, for it was quickly agreed upon by the rulers and citizens that, taken together, these effects amounted to a crisis. Furthermore, since the common factor of the various forms of the magical substance was something known to them as energy, the crisis was referred to as the "energy crisis." This subsumed all descriptions and had the benefit that the "energy crisis" could be whatever problem the speaker or listener thought it meant, without the impediment of having it mean the same thing to both.

In those days, it was commonly believed by the rulers of that great country that it was their responsibility to do something about such crises. So they gathered together to decide on a course of action and deliberated . . . and deliberated. In the meantime, there was trouble all over the land. Although it was evident that the supply of the magical substance had decreased, consumption did not correspondingly decrease, so its price increased.

Some consumers did not want to change their consumption levels and were willing to pay more for the magical substance. Other consumers claimed that, even if they wanted to change their consumption levels, they could not, through no fault of their own, but rather could and would pay more. Others said they could not change their *level of consumption and it would be a hardship to pay more; therefore, a portion of the supply should be set aside for them at the old price. Others felt it was not fair to allow those who could pay more to buy supplies without restriction; therefore, limits should be placed on the amount such persons could buy. Others felt it was everyone's duty to reduce consumption to the minimum. Others felt their uses of the substance were so important and the uses of others so frivolous, that the supply expended on frivolous uses should be taken away and reallocated to important uses. Others felt there was much waste of the substance and that everyone should pay more to force a reduction of such waste. Others felt that if the rulers were to permit exploration and extraction of the magical substance in present areas of repose, the supply would be greatly increased. Others — perhaps it will suffice to say that there were many different views on the matter.*

The happiness formerly known to this country had diminished and many feared it was gone forever. Reminders of greatness lost were evident on a daily basis in dimmed lights, slower transport speeds, tinier transporters, colder rooms in the winter, and hotter rooms in the summer. Everything became much more expensive because just about everything depended on the magical substance that had increased tremendously in price. As a result, there was so much sadness that, had it been possible to transform sadness into the magical substance, it would have been more than enough for everyone to once again feel strong, well, and happy.

In about five years, the rulers decided on a plan to help the country and its citizens cope with the "energy crisis," and, logically so, named the plan an "energy policy." Because there was much disagreement about what caused the energy crisis, and efforts to agree on the problem had been set aside to seek agreement on a solution, there was much disagreement on how to alleviate the crisis. Therefore, as was the custom of the rulers when faced with many unhappy industries and citizens, they tried to make everybody happy. This was, on the whole, a wise approach that had kept this rich and diverse country together for many years.

The "energy policy," therefore, was designed to increase happiness as much as possible among the citizens. It seemed unavoidable that some unhappiness would also result. However, there was the potential for more happiness than unhappiness. The citizens were told that the "energy policy" would place the country on a path in which the resulting changes would make many people better off and hardly anybody worse off. Some did not agree that it would be so. Others thought such a thing was impossible or, if it was possible at all, it was impossible to know whether it would be so. Most came to believe, however, that if even the most remote possibility existed *that it might be true, and the happiness to be gained was so great, it would be worth the effort to implement the "energy policy."*

This is how the "energy policy" came to be. And this is how it was decided that the "energy crisis" would be attacked with the moral equivalent of war.

Now begins the little story.

B. The Second Story

Long before the energy crisis, someone had discovered how to transform the magical substance into a form known as "electricity." The transformation was accomplished by taking the magical substance in its solid, liquid, or gaseous form and burning it. The heat from the fire was captured and used to boil water. The steam from the boiling water was channeled and used to turn the shaft of very interesting machines, called generators, that produced "electricity." The generated electricity was transmitted along wires and distributed to every industry and home in the country. Any time energy was needed for lighting, heating, cooling, or to run appliances or motors, a switch was closed in order to permit electricity to flow and perform its own peculiar magic. In many ways electricity was a more convenient form of energy than the original magical substance itself. A great industry grew around the production, transmission, and distribution of electricity.

As the demand for electricity grew, industrialists built bigger generators. They quickly learned that, as the size of generators increased, the average cost of producing a unit of electricity declined. This allowed them to make more money by either retaining the costs saved or by reducing the price of the electricity and increasing sales. They then learned something even more interesting. As the size of the generators increased and the size of the entire system increased, the cost of producing every additional unit of electricity also declined. This gave the larger producer a natural advantage over the smaller producer in that the larger producer always would be able to profitably offer a lower price. Since the consumer always would want to pay the lowest price, the smaller producer would lose his customers to the lower-cost producer. Indeed, this began to happen.

Citizens and their rulers became concerned that eventually only one producer would remain. This was not bad in itself, but the *thought occurred to many that once that happened, that one producer could raise prices to any level any time it wanted. The producer could do this to any particular consumer, even though his cost of production was declining, because consumers would not have an alternative, except for the unlikely alternative of not buying electricity at all. Furthermore, it was obvious that if all existing smaller producers had been priced out of business, then any new producer would meet the same fate, unless he could begin with all the same advantages of the largest producer. No one believed it was possible for a new business to begin that way.*

The citizens and rulers in the many principalities that comprised the country became so concerned that they decided each principality should commission a group of its citizens, a "Commission," to oversee the relationship between the producers of electricity and the consumers of electricity. This was most unusual for the country and its principalities, for there was a strong and commonly held belief that it was in everyone's best interest not to interfere with the relationship between producers and consumers. Nonetheless, it was decided that a reasonable compromise would be that, in exchange for guaranteeing an electricity producer the sole and exclusive right to produce, transmit, distribute, and sell electricity to a particular group of consumers, the Commission of citizens, now quasi-rulers called commissioners, would establish a fair price at which the electricity could be sold.

Many important issues were to be addressed over the years, such as what a "fair price" meant, but on the whole the really big issue of whether it was right or wrong to establish commissions with the remarkable power to intervene in the relationship between consumers and electricity producers had been settled. After awhile, everyone grew comfortable with this special arrangement. In fact, much to everyone's surprise, the producers and commissioners became better friends than anyone had expected. It worried some, occasionally, but on the whole, everyone was happy. Producers became very good at their business and built larger and larger plants. Consumers received an increasingly reliable supply of electricity at declining prices and the commissioners had little difficulty establishing a fair price. They just set a price that divided the benefits derived from this scheme between producers and consumers. It became a routine exercise. Everyone in this little story was very happy — until the "energy crisis."

As was the case in our larger story, the "energy crisis" also created difficulties among the parties in our little story. Almost the entire production of electricity depended on burning some form or another of the magical substance whose price was increasing tremendously. As a component of production costs, the price of the *magical substance became much more significant. The scheme that had been set up and followed for a long time, however, simply passed on these increased costs to the consumers of electricity. The consumers became very unhappy and complained to the Commissions administering this scheme. The Commissions referred them to the rulers, who, after all, set up the scheme, and they also began to question whether the producers actually had been doing as good a job as previously thought.*

There was much criticism leveled at the producers. Some said they had grown too comfortable doing the same thing over and over again and that it was unlikely they could effectively address the problems caused by the "energy crisis." Some felt that because the electricity producers were the only ones permitted to generate and sell electricity there was no opportunity for someone with new and competing ideas to take a risk of demonstrating that they too could profitably generate and sell electricity. To make things worse, some smaller industrialists stepped forward and said they could do a better job if only given the opportunity. This resulted in a reexamination of the electricity production industry and the scheme for administering it that had been set up by the rulers many years ago.

The reexamination concluded that, as beneficial as electricity had been, its development had been accompanied by some concerns. First, the process was not very efficient. In fact, one had to burn about three units of energy in any of the original forms of the magical substance in order to produce one unit of energy in the form of "electricity." Since the magical substance always had been plentiful, and therefore inexpensive, this had not mattered much in earlier times. It was now a serious concern. Second, the extraction of the magical substance in its original forms was felt by some to result in harm to the earth's land, air, and water. At first this had not mattered, but it was now believed that these harms should be considered as some of the costs of producing electricity. When this was done, it appeared that electricity was more expensive to produce than had been previously believed. Finally, the burning of the magical substance in all its original forms was incomplete. Burning of the magical substance in all its forms released gases harmful to the citizens, animals, plants, and the atmosphere itself. In addition, burning of the solid form left a hazardous residue that required special disposal. This, too, had not mattered in the beginning and formerly had not been considered a cost. Now it was.

All of these concerns in this little story were part of the larger *debate that led to the "energy policy." Since the "energy policy" tried to make everybody happy in some way, it is not surprising that these concerns were addressed as well. Some smaller industrialists had claimed they could do a better job of producing electricity than the large producers. In particular, they claimed they could produce electricity without using the magical substance. In doing so, the country would not only avoid its dependence on imports of the magical substance, the country also would avoid many of the environmental costs caused by the location, extraction, production, and combustion of the magical substance.*

These smaller industrialists said they could extract energy from the wind, the sun's rays, the rising and falling of the tide, and from the temperature differential of the oceans. They said that much of what the country considered "waste" contained much energy. They proposed to make electricity from the combustion of garbage, orchard prunings, and forest waste. Many of these smaller industrialists already burned the magical substance to produce steam for their industrial needs. Now they proposed to use that steam to produce electricity as well, either before or after they used the steam for their primary operations. The citizens and rulers were very pleased by the many ideas the crisis had brought forth. In fact, there were so many ideas some said it was difficult to tell the good from the bad.

The rulers were pressed to remove the impediments that stood in the way of achieving all that appeared so promising. And they did. First, large producers were obligated to purchase any electricity produced by smaller industrialists who qualified under certain rules to be developed later. This was necessary since a refusal to buy by the only potential buyer, who also happened to own the distribution system, would frustrate any proposed project. Second, those smaller industrialists who so qualified would be exempt from the authority of the Commissions which traditionally regulated producers of electricity. Oversight by the Commissions had become so complex, it was felt that, without this rule, there would be few industrialists interested in developing a project. Third, the larger producers could not acquire ownership of the smaller electricity producers. This rule was believed necessary because the large producers could buy out the smaller and either frustrate the project's development or use the project to escape the oversight of the Commissions. There were, of course, other rules, but these major rules were believed to be the critical ones.

It took some time to implement this part of the "energy policy." In fact, it took about three to five years from the time the "energy policy" was agreed upon or about eight to ten years from the time the imported supply of the magical substance was interrupted. The *obligation to buy was implemented by the traditional process of negotiating promises and counter-promises and many agreements were reached for the sale and purchase of electricity for the next twenty, and sometimes thirty, years. It often was difficult to reach agreement since it was difficult to imagine how things might change during that long period. It was especially difficult to imagine changes in the price of the magical substance, which was, after all, very critical to setting the value of the electricity to be generated. The Commissions assisted the process by developing agreements they considered fair, that the parties could use if they did not reach their own agreement. Many long-term agreements were thus entered into throughout the country.*

An interesting thing then happened. The countries which had collectively withdrawn the supply of the magical substance had decided several years before that it really was not in their interest to entirely hold back such supplies. They started to resupply everyone again. As a result, the price of the magical substance started to decrease. Those countries developed some internal differences and their collective agreement regarding the magical substance declined in importance. Consequently, some produced more and more of the magical substance in order to raise money for their needs. The price of the magical substance kept decreasing. In the meantime, there also had been a change in the rulers of the great country, in part because of the citizens' unhappiness with the way previous rulers had dealt with the general price effects of the "energy crisis." The new rulers did not believe in the "energy policy" developed by the previous rulers and were not very enthusiastic about continuing that plan.

Many things were reconsidered, including whether the promises to buy electricity from the small electricity producers should be kept according to the agreements that had been reached. Since promises were very important in this country, it had been decided that differences regarding promise-making and promise-breaking should only be settled by special judicial tribunals. This was a very strong and revered tradition. It happened, however, that in the case of the promises to buy electricity, the small and large producers avoided the special judicial tribunals and instead asked the Commissions to settle their differences. The Commissions enforced some promises, denied enforcement of others, and modified others, including those it had helped develop. The Commissions eventually grew tired of dealing with all of these promises and eventually told *the large producers that they could be in charge of enforcing their own promises. Obviously, some traditions regarding promise enforcement were quietly, unknown to many, changing.*

C. The Moral

Some saw irony in the fact that one of the most enduring legacies of the "energy policy" might be the changes brought about in some of the traditions involving promises. After all, imports of the magical substance now exceeded the level experienced before the "energy crisis" arose and few worried about this or the "energy policy" any more. Even fewer worried about the changes in the tradition of enforcing the promises made in our little story. These changes, however, reminded some elders that the basis of the current tradition of special judicial tribunals for the enforcement of promises, and other matters, was the result of a bad experience when the country had only one ruler who, among other things, enforced his own promises. It had proven unwise to rely on one who participated in the promise-making process to settle disputes regarding the validity, interpretation, and performance of that same promise.

II. INTRODUCTION

. . . long-settled rules about the process of making sure promises are kept are now disregarded by many parties.

Agency adjudication of contracts was once a sin in thought and deed against inviolable constitutional verities.[1] It was an evil particularized from the general sin of legislative delegation of judicial authority to administrative agencies.[2] As with Victorian sin, however, public condemnation did not stand in the way of private indulgence.[3] According to psychologists, a gap between ideals held and actual practice cannot be sustained and must be harmonized.[4] Like tectonic plates suddenly shifting to relieve accumulated strain, the Supreme Court, in several jolts, harmonized our constitutional ideals and agency practice.[5] Some agency adjudication of contracts is no longer a sin in thought or in deed and some constitutional verities are no

1. *See* Crowell v. Benson, 285 U.S. 22 (1932); Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. 272, 284 (1855) ("[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty . . . .").

2. *See id.*

3. Richard H. Fallon Jr., *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916 (1988) (rule against legislative delegation of judicial authority to administrative agencies was honored in the breach).

4. *See, e.g.*, LEON FESTINGER, A THEORY OF COGNITIVE DISSONANCE 137 (1957).

5. *See* Northern Pipeline Const. Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982); Thomas v. Union Carbide Agric. Prod., 473 U.S. 568 (1985); Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

longer inviolable.[6]

But all is not well in the body politic. Constitutional ideals cannot easily be decoupled. It became evident that adjudication of contracts by tribunals other than constitutional courts can involve other clear constitutional verities whose violation cannot be countenanced[7] — at least not yet. Agency adjudication of contracts also can impinge upon other constitutional ideals that are less clearly articulated[8] or that are ambiguously coupled with those which were directly transgressed upon.[9] Finally, we sustain our form of governance with non-constitutional verities so tightly interwoven with constitutional ideals that they, too, stand to be negatively affected by agency adjudication of contracts.[10]

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6. *See id.*

7. *See* Granfinanciera S.A. v. Nordberg, 492 U.S. 33 (1989) (addressing right to jury trial).

8. Though the Framers did not explicitly articulate the principles of checks and balances and separation of powers in the Constitution, these are underlying presumptions that provide the framework for the constitutional structure. As Madison reasoned:

> TO WHAT expedient, then, shall we finally resort, for maintaining in practice the necessary partition of power among the several departments, as laid down in the Constitution? The only answer that can be given is, that as all these exterior provisions are found to be inadequate, the defect must be supplied, by so contriving the interior structure of the government as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places.
>
> . . . .
>
> In order to lay a due foundation for that separate and distinct exercise of the different powers of government, which to a certain extent is admitted on all hands to be essential to the preservation of liberty, it is evident that each department should have a will of its own . . . .

THE FEDERALIST No. 51 (James Madison).

9. Agency adjudication of contracts, while more obviously transgressing upon the powers of the judiciary, also treads upon states' rights and raises significant issues of federalism. On the first level, federal agency adjudication of contracts impinges on the jurisdiction of state courts. *See, e.g.*, Ivy Broadcasting Co. v. American Tel. & Tel. Co., 391 F.2d 486 (2d Cir. 1968) (imposing federal common law to preserve uniformity of decision making at expense of state's right to adjudicate common law contract disputes normally within its jurisdiction).

On the second level, imposition of a federal regulatory structure on the states threatens to disrupt the states' own constitutional structures of checks and balances and separation of powers. If a state regulatory commission has not been given the power to adjudicate contracts, a federal scheme requiring agency adjudication directly conflicts with the state's internal delegation of power.

10. Agency adjudication of contracts threatens economic efficiency, certainty, and the legal rules that have developed to encourage them. Because our legal system developed within the framework of a market economy, economic efficiencies are embedded in the common law tradition and expressed through the range of remedies a court may award. Contracting parties appearing before a common law court know that a breach could cost them expectation damages or specific performance. Because agencies cannot

This article is essentially a call for a reconsideration of the practice and judicial sanction of the administrative adjudication of contracts.[11] To explicate the issues, the article will conduct a detailed

offer the range of remedies provided by common law courts, specifically expectation damages, agency adjudication of contracts threatens the efficiencies that have developed in the court system. A breaching party may hope to avoid the full costs of breach under agency adjudication and take risks the party would not contemplate if forced to litigate in court. Therefore, agency jurisdiction over contract disputes may encourage an inefficient breach, which leaves the damaged party with an insufficient remedy.

11. Administrative adjudication of a contract can result from a direct, a collateral, or a de facto adjudication of contractual rights. Direct adjudications result from an agency's exercise of express authority to adjudicate contracts. Collateral adjudications result from an agency determination that resolution of a contractual dispute was necessary to, inseparable from, and limited to effectuating the regulatory scheme. De facto adjudications result from agency resolution of contractual disputes framed, processed, and decided as a complaint, petition, application, or some other procedural device properly within the agency's jurisdiction.

Direct adjudications of contracts primarily are legislatively sanctioned, through a legislative delegation of authority to adjudicate contracts, although the courts monitor the extent to which such delegated authority encroaches on their judicial power. Collateral adjudications, although resulting from implementation of legislatively-derived regulatory schemes, primarily are judicially sanctioned through expansive interpretations of the agency's authorizing legislation. At the federal level, judicial sanction of such collateral contractual adjudications has provided the basis for "federal judicial lawmaking in many areas in which a general regulatory scheme has been enacted by Congress." JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE 229 (2d ed. 1993); *see also* Textile Workers Union of Am. v. Lincoln Mills, 353 U.S. 448 (1957) (National Labor Relations Board); Pennzoil Co. v. Federal Energy Regulatory Comm'n, 645 F.2d 360 (5th Cir. 1981) (Federal Energy Regulatory Commission); Ivy Broadcasting Co. v. American Tel. & Tel. Co., 391 F.2d 486 (2d Cir. 1968) (Federal Communications Commission).

De facto adjudications have neither legislative nor judicial sanction and, but for the masking of their true nature by the contrivance of an acceptable (to all parties) bureaucratic form of action, normally would be considered ultra vires or unconstitutional. (In many ways the use of agencies to resolve contractual disputes through de facto adjudications is reminiscent of efforts to use the courts of equity as an alternative to the common law courts in medieval England. *See* EDGAR BODENHEIMER ET AL., AN INTRODUCTION TO THE ANGLO-AMERICAN LEGAL SYSTEM: READINGS AND CASES, Ch. 2 (2d ed. 1988). The parallels are many but one particularly apropo aspect for our purposes is that, eventually, a détente in the rivalry between the courts of equity and courts of law resulted from a mutually accepted general rule that courts of equity would not assume jurisdiction if there was an adequate remedy at law — i.e., damages. This is an idea not fully developed in the replay of this old drama before the regulatory agencies conducting de facto adjudications.)

The artifice of the procedural contrivance in a de facto adjudication suggests a consent, and perhaps preference, by the adverse parties to have their contractual dispute adjudicated by the agency. Such mutual consent is accompanied by a Faustian bargain with the agency, since judicial review of the agency's decision is usually discretionary (at least at the state level) and, if granted, the standard of review is usually highly deferential, leading to the agency's determination being the last word on the matter.

Finally, it is helpful to keep in mind that the balance of law and policy considerations regarding the propriety of agency adjudications varies according to the type of adjudication. Direct adjudications do not generally present questions of legal propriety since the express nature of the authorizing legislation and the basis for the agency decision is clear and probably has had a scrubbing of constitutional infirmities through the anticipation of judicial review. There are, however, significant policy considerations. Should the legislature authorize it? What should be the extent of discretion permitted the agency to exercise such authority? What shall be the basis of the agency's exercise of discretion of such examination, in a sense a legal and policy autopsy, of the adjudication of Qualifying Facility (QF) contracts[12] by rate regulatory agencies. The broader case regarding the adjudication of contracts by administrative agencies will be made by the process of abstraction of the particular and particularization of the abstract[13] to reveal the dimensions of matters of governance implicated by agency adjudication of contracts. The article can, therefore, be considered at three levels. At the first level, it is about the propriety of the adjudication

authority? With respect to collateral adjudications, the starting point is a general regulatory scheme which in its generality subsumes policy considerations. At the forefront are legal considerations. Legal determinations must be made by a reviewing court, or an agency anticipating judicial review, of whether the contractual adjudication is severable from the agency's regulatory determination. If not, determinations must be made whether it is necessary to adjudicate the contractual rights of the parties; if necessary, what law to apply to the contractual adjudication; and, finally, what legal effect to give to the adjudication. With respect to federal agencies, such collateral contractual adjudications have proven to be particularly vexatious. The first step has been a finding of a preemptive federal regulatory scheme, the second step has been a displacement of state substantive law, and the third step has been the simultaneous development and application of federal common law. Federalism principles are clearly at stake with respect to what law to apply. This alone would make the legal considerations more prominent than the policy considerations. Finally, the state and federal courts, seemingly in an act of contrition for their forays in judicial lawmaking, take pains to limit, in a theoretical sense, the legal effect of collateral contractual adjudications. For example, in a rate regulatory setting, a contractual adjudication may be necessary to establish a rate. However, the court will state that it is giving legal effect to the rate, not to the contractual adjudication. Enforcement of that contractual adjudication is, in a technically legal sense, left to another court for another day. The practical outcome, however, is that the collateral adjudication almost always effectuates both, especially in the case of some Federal Energy Regulatory Commission adjudications of gas contracts where the rate was essentially the contract.

De facto adjudications by administrative agencies, however, present both legal and policy considerations. The policy masque on their ultra vires and unconstitutional nature puts them beyond the rule of law (which is disturbing, to say the least, in a nation of laws) and leads to a dual system of contractual adjudications. That dual system does not have uniform remedial powers, which leads to differing incentives in making and keeping promises. Since agency decision-making is not bound by a tradition of stare decisis, de facto contractual adjudications by administrative agencies will be considerably buffeted by the vagaries of policy.

12. For the purposes of this article, a QF contract is a contract, meeting the requirements of Section 210 of The Public Utility Regulatory Policies Act of 1978 (PURPA), between a qualifying facility (QF) and a private investor-owned electric utility regulated by a public utility commission. The Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, § 210, 92 Stat. 3144-47 (codified as amended in scattered sections of 15 & 16 U.S.C.) [hereinafter PURPA § 210].

13. *See* Michel Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769, 807-808 (1985) ("[T]hrough the dual process of abstraction of the particular and particularization of the abstract, modern contractual relationships, the individual participants, and the social, political, and economic context in which it takes place, are given shape.").

of QF contracts by a state agency, in particular the California Public Utility Commission (CPUC), or a federal agency, the Federal Energy Regulatory Commission (FERC). At the second level, it is about the propriety of the administrative adjudication of private contracts in general.[14] At the third level, it is about the propriety of federal law[15] directing a state administrative agency to adjudicate a private contract, in particular a contract between a QF and a utility.

A. QF Contracts and State Agency Adjudication

With respect to the first level, California's experience is not as parochial as it may first appear. California is a prominent and "successful" example of the implementation of federal policies designed to encourage QF power generation.[16] Between 1983 and 1988 "QF development in California alone exceeded many projections of the potential for the entire nation through the year 2000."[17] By 1990, although California had only one-third of the West's total existing electric capacity, it had eighty-five percent of the region's capacity from qualifying facilities,[18] thus permitting it to engage in some self-congratulatory boasting[19] that it led the nation in the amount of electricity supplied by non-utility generators, and that it had one of the world's most diverse mixes of electricity production.[20] Although

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14. This paper focuses on agency adjudication of private contracts between private parties (such as QF contracts referred to in note 12, *supra*) as distinguished from public contracts. Generally, in a public contract one of the parties is a local, state, or federal governmental unit.

15. Used in this context, "federal law" refers to a combination of federal statutes, regulations, policy statements, and case law. *See, e.g.*, PURPA § 210, *supra* note 12; Policy Statement Regarding the Commission's Enforcement Role under Section 210 of the Public Utility Regulatory Policies Act of 1978, 23 F.E.R.C. ¶ 61,304 (1983) [hereinafter Policy Statement]; Regulations Governing Independent Power Producers, 53 Fed. Reg. 9327 (1988); 18 C.F.R. § 292 (1993); Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742 (1982).

16. *See, e.g.*, I. C. BUPP, CAMBRIDGE ENERGY RESEARCH ASSOCIATES, GAINING STEAM? THE FUTURE OF COGENERATION (1989). In discussing cogeneration and small power production by non-utility companies under PURPA the report states "in California, a friendly state regulatory environment, combined with generous state and federal tax incentives, gave birth to a business in which power plants were built with a thermal application designed to qualify for these incentives . . . . During the past several years, the business of building power plants that, in effect, double as cogeneration facilities spread beyond California, first into Texas and Louisiana and more recently into the East and Midwest." *Id.* at 2.

17. STEVEN J. FERREY, LAW OF INDEPENDENT POWER: DEVELOPMENT, COGENERATION, UTILITY REGULATION 3-10 (1990).

18. CALIFORNIA ENERGY COMM'N, PUB. NO. 106-90-002, ELECTRICITY REPORT 24 (1990).

19. "California's leadership in non-utility ownership resulted from aggressive implementation of the Public Utilities Regulatory Policies Act (PURPA) of 1978, state and federal tax incentives and the [California Energy] Commission's technology development programs, which accelerated the pace of efficient and renewable generating resources." *Id.*

20. *Id.*

QF contracts may appear somewhat arcane, and are used in this article as a heuristic device for abstracting broader issues, their considerable economic significance in California makes them, in and of themselves, more than a worthy subject of inquiry. By 1993, there were 954 QF projects in California with an on-line nameplate capacity of 10,000 megawatts,[21] generating 50,000 gigawatt-hours of electricity, 27% of the total amount of energy generated statewide by the investor-owned electric utilities. By 1993, the total investment in these QF projects was $18.77 billion and the projects had produced direct employment of 139,364 persons. This capital investment is expected to have an economic impact of approximately $37 billion on California's gross state product in 1993.[22] The payments made by investor-owned utilities to QFs for capacity and energy in 1993 will amount to $3 billion, including $2.5 billion in energy payments and $500 million in capacity payments.[23]

Additionally, the analysis of the propriety of the CPUC adjudicating QF contracts has general applicability since the relevant rate regulatory agency of every state is confronted with a similar challenge in implementing Section 210 of PURPA.[24] Although rate regulation admits of much variety throughout the country,[25] the

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21. For comparison purposes, a base-load generating plant, usually a nuclear, coal, or gas-fired plant, has 1,000 megawatts of generating capacity.

These estimates were supplied to the author by the staff of the California Energy Commission. Supporting documents are on file with the author. These estimates are, in the author's judgment, more reliable than many other estimates whose derivation is often unclear. In this instance the statistics on QFs are derived from the Commission's QF databases for the investor-owned utilities. The estimates on capital investment were derived from plant costs by alternative energy technology category (biomass, cogeneration, geothermal, hydroelectric, solar, waste-to-energy, and wind) set forth in 1 & 2 CALIFORNIA ENERGY COMM'N, 1992 ENERGY TECHNOLOGY STATUS REPORT, App. A (1992). The estimates on payments to the QFs were derived from ELFIN (electricity financial) model runs. See DAVID ROE, DYNAMOS AND VIRGINS (1984) for a highly readable, informative, and entertaining account of the development, significance, and eventual acceptance of the ELFIN model. The estimates of employment were derived using an input-output (I/O) model developed by the Oak Ridge National Laboratory for the California Energy Commission, which is based on an I/O model updated by the Bureau of Labor Statistics.

22. *See supra* note 21. The multiplier effect, the amount of GSP (gross state product) generated by each dollar of investment, has been computed to be 2.19 for capital costs and 1.92 for O&M (operations and management) costs. For simplicity, a multiplier of 2.0 was used for this estimate.

23. *See supra* note 21.

24. The Public Utility Regulatory Policies Act of 1978 § 210(f), 16 U.S.C. § 824a-3(f) (1988). For a discussion of the implementation of federal legislation through state structures, see generally Saikrishna B. Prakash, *Field Office Federalism*, 79 VA. L. REV. 1957 (1993).

25. THE COUNCIL OF STATE GOVERNMENTS, THE BOOK OF THE STATES 552-54

differences are not material for the issues addressed in this article. Our inquiry would be somewhat remiss, however, if one of these differences was not examined further.

This difference is the fact that some state rate regulatory agencies are statutory creations while others have some constitutional basis.[26] In this regard, the question of the propriety of the CPUC adjudicating QF contracts is also especially interesting since it is a rate regulatory agency with such a constitutional basis.[27] Therefore, in contrast to a statutorily created rate regulatory agency, which possesses only those powers expressly granted, the CPUC possesses some inherent constitutional powers.[28] Consequently, whether the inherent powers of a state rate regulatory agency with a constitutional basis include the power to adjudicate contracts becomes a question with significant state and federal policy implications.

(1992).

26. Of 25 leading QF states selected from FERREY, *supra* note 17, at 3-50, five have utility commissions specifically established in their constitutions: Arizona, ARIZ. CONST. art. 15; California, CAL. CONST. art. XII; Colorado, COLO. CONST. art. 25; Georgia, GA. CONST. art. 4, § 1, Para. 1; and Oklahoma, OKLA. CONST. art. 9, §§ 15-35. The legislature has created the utility commissions in the other 20 states by statute: Alabama, ALA. CODE § 37-1-1 (1992); Arkansas, ARK. CODE ANN. § 23-2-301 (Michie 1987); Florida, FLA. STAT. ANN. § 350.011 (West 1968); Hawaii, HAW. REV. STAT. §§ 269-2, -6 (1985 & Supp. 1992); Idaho, IDAHO CODE § 61-201 (1976); Maine, ME. REV. STAT. ANN. tit. 35-A, § 103 (West 1988); Maryland, MD. ANN. CODE art. 78, § 3 (1991); Massachusettes, MASS. GEN. L. ch. 25, § 1 (1981); Michigan, MICH. COMP. LAWS ANN. § 460.1 (West 1991) (MICH. STAT. ANN. § 22.13 (1) (Callaghan 1984)); Minnesota, MINN. STAT. § 216A.01 (1992); Mississippi, MISS. CODE ANN. § 77-1-1 (1991); Nevada, NEV. REV. STAT. § 703.021 (1993); New Hampshire, N.H. REV. STAT. ANN. § 363:1 (1984); New Mexico, N.M. STAT. ANN. § 62-5-1 (Michie 1993); New York, N.Y. PUB. SERV. LAW § 4 (McKinney 1989); Ohio, OHIO REV. CODE ANN. § 4901.02 (Baldwin 1992); Oregon, OR. REV. STAT. § 756.014 (1991); Texas, TEX. REV. CIV. STAT. ANN. art. 1446c § 5 (West Supp. 1993); Utah, UTAH CODE ANN. § 54-1-1 (1990); Vermont, VT. STAT. ANN. tit. 30, §§ 1-2 (1986 & Supp. 1992); Washington, WASH. REV. CODE § 80.01.010 (1991).

27. CAL. CONST. art. XII, § 1.

28. *See, e.g.*, Dorothy J. Glancy, *State Administrative Law Issues, in* CALIFORNIA ENVIRONMENTAL LAW 10, 10 (Kenneth A. Manaster & Daniel P. Selmi, consultants, 1990). Consumers Lobby Against Monopolies v. Public Util. Comm'n, 25 Cal. 3d 891, 905, 603 P.2d 41, 49, 160 Cal. Rptr. 124, 132 (1979), stated:

> The commission is a state agency of constitutional origin with far-reaching duties, functions and powers. The Constitution confers broad authority on the commission to regulate utilities, including the power to fix rates, establish rules, hold various types of hearings, award reparation, and establish its own procedures.
>
> The commission's powers, however, are not restricted to those expressly mentioned in the Constitution: "The Legislature has plenary power, unlimited by the other provisions of this constitution but consistent with this article, to confer additional authority and jurisdiction upon the commission . . . ."
>
> Pursuant to this grant of power the Legislature enacted Public Utilities Code section 701, conferring on the commission expansive authority to "*do all things*, whether specifically designated . . . *or in addition thereto*, which are necessary and convenient" in the supervision and regulation of every public utility in California. The commission's authority has been liberally construed.

Id. (citations omitted).

If answered in the affirmative, desirable uniformity in the implementation of Section 210 of PURPA is doubtful because statutory rate regulatory agencies cannot similarly adjudicate contracts, including QF contracts, without express state legislative authority or decisional law which permits it. However, legislative efforts to grant statutory rate regulatory agencies such power may be limited by other state constitutional considerations[29] — unless accomodating state constitutional changes accompany the grant of contractual adjudicatory power.

It is unlikely that such efforts and changes would be or could be collectively undertaken by states with statutorily based rate regulatory agencies for the purpose of "fixing" a non-uniformity problem among the states on the matter of contractual adjudicatory jurisdiction.[30] This is so especially when that problem is one created by a federal law which is insistent not only on state implementation but on implementation by a particular state agency, i.e., the relevant rate regulatory agency.[31] However, even with such changes, contractual adjudication by agencies (including a constitutional one such as the California Public Utilities Commission) would produce very different results from contractual adjudication by state courts, unless the agencies were granted the same contractual remedial powers as courts.[32] This, too, is a rather doubtful proposition.

Ironically then, a finding of inherent power to adjudicate contracts in a constitutionally based state agency would lead to significant non-uniformity in implementation of federal policy. This would suggest the corrective measure of federal preemption of state contractual adjudicatory authority.[33] With respect to power contracts, the

29. Imposing a federal regulatory scheme onto states challenges the states' constitutional separation of powers and raises questions regarding the continued viability of the 10th Amendment. *See* discussion, *supra* notes 8 & 9.

30. For articles with contrasting perspectives on how to address uniformity problems, see Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); James J. White, *Ex Propio Vigore*, 89 MICH. L. REV. 2096 (1991).

31. The Public Utility Regulatory Policies Act of 1978 § 210(f), 16 U.S.C. § 824a-3(f) (1988).

32. *See supra* note 10 and *infra* Section V.A. (regarding efficiency models and remedial implications).

33. *See* Ivy Broadcasting Co. v. American Tel. & Tel. Co., 391 F.2d 486 (2d Cir. 1968) (imposing federal common law as decided by district court to preserve uniformity of decision making at expense of a state's right to adjudicate common law contract disputes normally within its jurisdiction); Illinois v. City of Milwaukee, 406 U.S. 91, 105 n.6 (1972) (applying federal common law to preserve "an overriding federal interest in the need for a uniform rule of decision . . . .").

Another solution to the problem of non-uniformity would be for the states to rely upon agency upon which such contractual adjudicative authority would then be lodged is most logically the FERC. Most immediately, such a finding would suggest a necessary modification of PURPA and its implementing regulations, which would clearly preempt any state role in QF contractual adjudication.[34]

If answered in the negative (that is, the inherent powers of a constitutionally based state agency do not include the power to adjudicate contractual disputes), the line of demarcation of adjudicative authority between the state regulatory agency and the state judiciary is clear and would comport with existing state constitutional structures.[35] Such a finding would delimit not only the contractual adjudicatory authority of a constitutionally based agency, but quite clearly all similar agencies in states where the constitutional structure is similar and for which there is a lesser basis (statutory authority rather than constitutional authority) for the agency. Most immediately, the general policy implication for implementation of federal laws, such as PURPA and the regulations promulgated under its authority, which call upon the states to resolve disputes between private parties, would be to channel such dispute resolution into state courts. In particular, such a finding would suggest that state rate regulatory agencies should refrain from adjudications of contractual disputes between QFs and utilities.

B. IPP Contracts and Federal/State Agency Adjudication

Some aspects of the second level at which this article can be taken, the general propriety of the adjudication of private contracts by administrative agencies, have been addressed in the preceding discussion regarding state administrative agency authority to adjudicate contracts. Federal decisional law substantially informs that analysis.[36] However, it is also the case that state analysis informs the federal analysis at this level, particularly the analysis of the

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the Conference of Commissioners of Uniform State Laws. Indeed, this may be the more proper approach since even the very creation and existence of this Commission questions the propriety of federal preemption in some areas. *See generally* White, *supra* note 30, at 2100.

34. There is some disagreement as to how far PURPA already preempts state regulation of QF contracts. FERC suggests that section 210(h) of PURPA authorizes the Commission "to undertake an enforcement action to require a State regulatory authority or nonregulated electric utility to implement the Commission's [QF] regulations." Policy Statement, *supra* note 15. Alternatively, the Supreme Court states that "[t]here is nothing in PURPA 'directly compelling' the States to enact a legislative program." Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 765 (1982). "As we read them, Titles I and III simply establish requirements for continued state activity in an otherwise pre-emptible field." *Id.* at 769.

35. *See* discussion, *supra* notes 8 & 9 (regarding separation of power and checks and balances).

36. McHugh v. Santa Monica Rent Control Bd., 49 Cal. 3d 348, 365 n.16 (1989),

implications of the difference in remedial powers between administrative agencies and courts.[37] Additional analysis of the federal decisional law related to the general propriety of the adjudication of private contracts by federal administrative agencies is, however, required not only by the possibility of the necessity of federal preemption over QF contracts, but also by the morphogenesis of the status of independent energy producers and the contractual relationship between independent energy producers and electric utilities.

Prior to PURPA, the world of electricity regulation was divided on the basis of whether the sale of electricity was retail or wholesale.[38] States regulated retail transactions and the federal government regulated wholesale intrastate transactions.[39] An electric utility usually engaged in both and was, therefore, subject to both state and federal rate regulation. In addition, to prevent industry abuses of the holding company structure, the Public Utility Holding Company Act of 1935 regulated, through the Securities and Exchange Commission (SEC), some aspects of the capital structure of an electric utility.[40] There was not much room for independent power production[41] and the pervasive and complex regulatory requirements acted as a significant barrier to entry. It was a simpler regulatory world.

It has become much more complicated since PURPA. PURPA obligated electric utilities to make wholesale purchases of electricity from "qualifying facilities" (QFs) and generally exempted power

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777 P.2d 91, 101 n.16, 216 Cal. Rptr. 318, 328 n.16 (1989); *see also id.* at 384, 777 P.2d at 115, 216 Cal. Rptr. at 342 (citing United States Supreme Court opinions in support of its discussion of Board's authority to adjudicate rent dispute, award treble damages, and resolve McHugh's jury trial claim).

37. *See* Section V, QF CONTRACTUAL ADJUDICATION AND REMEDIAL EFFICIENCY.

38. In 1935 Congress enacted Part II of the Federal Power Act to allow federal regulation of wholesale sales of electricity in interstate commerce. *See* Public Utility Holding Company Act of 1935, Pub. L. No. 95-617, 49 Stat. 847 (codified as amended at 16 U.S.C. §§ 824-824k (1982)); 16 U.S.C. § 824(a), (b)(1) (1988); Federal Power Comm'n v. Southern Cal. Edison, Co., 376 U.S. 205 (1964); Federal Power Comm'n v. Florida Power & Light, 404 U.S. 453 (1972).

39. *See supra* note 38. "The term 'sale of electric energy at wholesale' when used in this subchapter, means a sale of electric energy to any person for resale." 16 U.S.C. § 824(d) (1988).

40. Public Utility Holding Company Act of 1935, Pub. L. No. 102-486, 49 Stat. 838 (codified as amended at 15 U.S.C. §§ 79 to 79Z-6 (1988 & Supp. IV 1992)); *see also* JOSEPH P. TOMAIN ET AL., ENERGY LAW AND POLICY 449 (1989).

41. A public utility generally had monopsony control of the market. As the only buyer in the market, the utility could impose unreasonable interconnection requirements and wheeling restrictions, making independent power production unappealing. The Energy Policy Act of 1992 has addressed some of these problems. Energy Policy Act of 1992, Pub. L. No. 102-486, 102 Stat. 2776 (codified at 42 U.S.C.A. §§ 13201-13556 (West Supp. 1993)).

production and sales from those facilities from federal and state rate regulation and the Public Utility Holding Company Act.[42] PURPA, however, imposed size, fuel, efficiency, and ownership limitations on a facility with QF status.[43] Many investors, including electric utilities operating outside their state retail regulated service areas, wished to build large conventional power plants to sell electricity in the wholesale market. About this time, electricity rate regulation became more market-oriented. State regulatory commissions and FERC began to develop a framework to give incentives to investors to procure wholesale electric power through various bidding schemes.[44] Through this, a new type of electricity generator developed, subject only to FERC regulation — the Independent Power Producer (IPP).[45] QFs and IPPs began competing in the wholesale power market along with utilities which had traditionally engaged in wholesale power transactions. The stakes were significant.

One indicator of the national economic significance of contracts between IPPs and utilities is that $27.8 billion of financing "tombstone" notices for independent power projects appeared in the Wall Street Journal between 1986 and 1990.[46] It is estimated that $100 billion will be invested in this decade in such projects and that by the year 2000 independent power projects and QFs will earn $32 billion in annual revenue.[47] Independent power on-line grew at an average annual rate of seventeen percent between 1988 and 1991.[48] A crossover point was reached in 1991, when capacity additions by IPPs exceeded those of the electric utilities for the first time since establishment of the nationwide electric grid.[49]

Pressure mounted at FERC to clarify the ground rules for IPPs in this market. Consequently, FERC initiated a Notice Of Proposed Rulemaking (NOPR) to develop guidelines for this market while

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42. Public Utility Regulatory Policies Act of 1978 § 210(e), 16 U.S.C. § 824a-3(e) (1988 & Supp. IV 1992).

43. Public Utility Regulatory Policies Act of 1978 § 201, 16 U.S.C. § 796(17)(C) (1988 & Supp. IV 1992).

44. *See* FERREY, *supra* note 17, § 9.

45. A QF which, for whatever reason, lost its qualifying status could also become an independent power producer engaged in a wholesale transaction of electricity and would immediately become an IPP subject to federal regulation.

46. FERREY, *supra* note 17, § 3.01[2]. Ferrey comments that these notices understate the actual amount of development by taking into account self-financed projects and small projects for which no notices are filed. *Id.*

47. *Id.*

48. *Id.* § 3.01[1] (citing EDISON ELEC. INST., 1991 CAPACITY AND GENERATION OF NON-UTILITY SOURCES OF ENERGY (1992)).

49. *Non-Utilities Are Expected to Bring More New Capacity On-Line*, INSIDE F.E.R.C., March 25, 1991, at 8.

continuing to rule on IPP matters on a case-by-case basis.[50] The Energy Policy Act of 1992, however, overtook this effort and complicated the electric regulatory scene even more.

The Energy Policy Act defined a new category of IPP, an "exempt wholesale generator." This category was exempt from SEC and FERC regulatory requirements that had impeded the development of IPPs.[51] The Energy Policy Act also allowed a scheme in which the exempt wholesale generator could generate electricity within one utility's service area and transmit its power through one or more utility service areas to a purchasing utility.[52] Before these regulatory changes had begun to settle, however, another variation developed, an exempt wholesale generator (EWG) that also had QF status, called an EWG-QF.[53]

With state and federal administrative agencies regulating the rate of return of utilities purchasing electricity from four different independent energy producers, there will continue to be many opportunities and temptations for those agencies to engage in the adjudication of contracts for many years to come.[54] Based on the QF experience, it is not unreasonable to conclude that the pressures for state regulatory commissions or FERC to adjudicate contract disputes may very well increase because there will be many more contracts required between the EWGs and utilities than was the case with QFs.

For example, PURPA not only obligated utilities to buy electricity

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50. Regulations Governing Independent Power Producers, 53 Fed. Reg. 9327 (1988); *see also* Order Terminating Proceedings, 64 F.E.R.C. ¶ 61,364 (1993) (explaining the history of FERC attempts to regulate IPPs and how the Energy Policy Act of 1992 overtook its efforts).

51. Energy Policy Act of 1992, Pub. L. No. 102-486, § 711, 102 Stat. 2905 (codified at 42 U.S.C.A. §§ 13201-13556 (West Supp. 1993).

52. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, also made moot FERC's IPP NOPR and the rulemaking was terminated. *See* Order Terminating Proceedings, 64 F.E.R.C. ¶ 61,364 (1993).

53. Qualifying facilities apply for Exempt Wholesale Generator status to create this regulatory hybrid of an EWG-QF. *See* Malacha Hydro Ltd. Partnership, 62 F.E.R.C. ¶ 61,184 (1993); Richmond Power Enter. L.P., 62 F.E.R.C. ¶ 61,157 (1993) ("[T]here is nothing in the Energy Policy Act or its legislative history to indicate that a facility that satisfies the requirements for QF status may not also be an eligible [EWG] facility if it meets the statutory definition of an elgible facility."); Thermo Power & Elec., Inc., 64 F.E.R.C. ¶ 62,123 (1993).

54. It was recently estimated that 93,300 megawatts of non-utility generation were under development in the U.S., of which 37,000-40,000 megawatts would come on line by 2000. It also was estimated that the Energy Policy Act of 1992 would shift 7,000 to 8,000 megawatts of QF projects to EWGs by 2000. This would result in about 25% of the capacity additions by 2000 coming from EWGs. *RCG/Hagler, Bailly: 93,300 MW Planned in U.S., 290,000 MW Internationally*, INDEPENDENT POWER REPORT (April 9, 1993).

from QFs, but it also obligated the utilities to interconnect with the QFs.[55] In California, this resulted in two contracts with the QF: the Power Purchase Agreement (PPA) and the Interconnection Facilities Agreement (IFA).[56] The PPA usually became the contract in dispute between the parties and received the bulk of the policy concern. The IFA was rarely at the center of contractual disputes, except insofar as a utility made it an issue in order to leverage changes in the PPA.[57] In part, this was because the IFA was originally intended to be a rather ministerial document dealing with technical matters such as interconnection hardware specifications and system reliability operating parameters.[58] The IFA dealt with several matters, however, that may assume greater importance in the new world of EWGs and EWG-QFs and may possibly result in greater regulatory involvement than had previously been the case.

First, the IFA was the utility's unilateral determination of the technical specification of the interconnection.[59] Those affiliated with QFs generally felt that a utility would take advantage of the occasion to upgrade and "goldplate" facilities that were arguably related to the interconnection. Second, the IFA contained the utility's unilateral allocation of interconnection costs. Some of the costs paid for by QFs were for equipment in which ownership would vest with the QFs, while some were for equipment in which the QFs would deed ownership to the utility. Third, the IFA specified the so-called Contributions In Aid of Construction (CIAC) taxes that the QF had to pay the utility. When equipment was deeded to the utility, the utility would incur a tax liability. The QF was obligated to pay the tax to make the utility whole. A large part of the CIAC tax payment was, however, for a contingent tax liability that might occur in twenty or

55. Public Utility Regulatory Policies Act of 1978 § 202, 16 U.S.C. 824i (1988).

56. *See* Transmission Constraints on Cogeneration and Small Power Production Development, 17 C.P.U.C.2d 87 (1985) (setting out QF milestone procedures, including entering into a PPA and IFA if the QF hopes to maintain its interconnection priority).

57. In Colmac Energy, Inc. v. Southern Cal. Edison Co., 31 C.P.U.C.2d 549 (1989), Edison attempted, but failed, to make Colmac's inability to complete an IFA a material issue in the dispute over modification of the PPA; *see also* Sayles Hydro Ass'n. v. Pacific Gas & Elec. Co., Dec. No. 90-12-074, 1990 Cal. PUC LEXIS 1393 (1990).

58. The ministerial nature of the IFA is apparent from its treatment in the Qualifying Facility Milestone Procedures (QFMP). *See, e.g.*, Transmission Constraints on Cogeneration and Small Power Production Development, 17 C.P.U.C.2d 87 (1985). Additionally, one utility, San Diego Gas & Electric, eliminated the IFA by integrating it into the PPA in its Special Facilities Agreement. *See* Investigation Into the Transmission System Operations of Certain California Electric Corporations, 1985 Cal. PUC LEXIS 1134 n.1 (1985).

59. *See In Re* Investigation into the Transmission System Operations of Certain California Electric Corporations Regarding Transmission Contraints on Cogeneration & Small Power Production Development, Dec. No. 87-04-039, 1987 Cal. PUC LEXIS 676, 24 C.P.U.C.2d 144 (1987) (setting forth the revised Qualifying Facility Milestone Procedure).

thirty years.[60]

EWGs are likely to require, at a minimum, three contracts in order to effect a power sale. The first contract will be an IFA with the local interconnecting utility. There will also be one or more "wheeling" contracts with utilities for transmitting the EWG-generated power across their service areas. Finally, there will be a PPA between the EWG and the purchasing utility. Since the IFA and PPA are likely to be with different utilities, the opportunity to offset losses and gains between these two contracts (as was the case with QFs, in which only one utility was involved) will be lost. This means that the IFA will be subject to much more bargaining and greater possibilities of disputes arising over performance. "Wheeling" has always been a difficult proposition. The pricing of the service is likely also to involve substantial disputes over cost allocations and the terms and conditions of systems operation. Finally, the PPA will now also have to stand alone. It is likely to continue to encounter the same challenges in performance that present PPAs have faced.[61] Perhaps, now more than ever, it would be prudent to anticipate what the appropriate administrative agency response should be to the pressures and requests to adjudicate contractual disputes that will arise from any of the possible permutations of independent power producers, interconnecting utilities, wheeling utilities, and purchasing utilities.[62]

60. *See In Re* Investigation into the Methods to be Utilized by the Commission to Establish the Proper Level of Expense for Ratemaking Purposes for Public Utilities due to the Changes Resulting from the 1986 Tax Reform Act of 1986, Dec. No. 87-09-026, 25 C.P.U.C.2d 299 (1987). In this decision, the CPUC recognized that the Tax Reform Act of 1986 imposed federal income tax on CIAC. In response, the CPUC adopted the principle that the person who causes the tax pays the tax. Decision 87-09-026 sets out a variety of formulas to compute CIAC tax due to utilities and QFs. The CPUC decision since has been modified but the principle remains that CIAC taxes, once a future obligation, have become a present liability.

61. *See infra* Section III.A.

62. Recent state regulatory initiatives aimed at increasing market competition in the electric industry, if carried to their intended conclusion, will also greatly increase the number of buyers and sellers of electricity. Thus the number of possible contractual relationships, along with the attendant potential for contractual disputes, will geometrically increase. One of the most far-reaching initiatives proposes to permit consumers of electricity the traditional choice of continuing to receive service from their local electric utility or the choice of contracting for their electricity from other electricity generators, brokers, marketers, or other service providers. See Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation (R.94-04-031) and Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation (I.94-04-032), April 20, 1994 wherein the CPUC stated:

[O]ur proposed vision represents the next logical and desirable step in an

C. *PURPA, Federalism, and State Agency Adjudication*

Finally, as stated above, the third level at which this article may be taken is with respect to the matter of the propriety of *federal* law directing a *state* administrative agency to adjudicate a private contract. Even a federalist's conscience might be shocked by such a federal law. Not surprisingly, it cannot be found as a clear expression of federal legislation. What can be found, however, are resolutions (adjudications) of disputes (contractual matters) by rate regulatory commissions (state administrative agencies) under authority of FERC's rules (federal regulations) issued under authority of PURPA (federal legislation).

Congress directed FERC to prescribe, within one year of PURPA's enactment, rules to encourage cogeneration and small power production.[63] The grant of authority to do so was rather broad: "such rules as it determines necessary."[64] Congress then directed each state regulatory authority to implement FERC's rules, within the year of FERC's promulgation of such rules, for each electric utility for which it had ratemaking authority.[65] FERC fulfilled Congress' mandate with a rule that provided implementing options for state regulatory authorities. The final rule provided that, "implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities . . . or any other action reasonably designed to implement [FERC's rules]."[66] The section-by-section analysis in the final rule added definition to the rather murky phrase "an undertaking to resolve disputes,"[67] restating it as "application on a case-by-case basis by the State regulatory authority . . . of the rules adopted by the Commission . . . ."[68] The "application on a case-by-case basis" of FERC's

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> evolution begun in earnest with the passage of the Public Utility Regulatory Policies Act of 1978 (PURPA), and advanced in 1992 by passage of EPAct [Energy Policy Act of 1992] . . . .
>
> Our proposal is designed to launch us from the end of one era — that of PURPA — to the beginning of a new era articulated by EPAct. It will, if implemented, result in a more competitive, consumer-driven electric services industry.

Id. at 19. See also *id.* at 19 n.16 for a description of similar initiatives in Michigan and Connecticut.

63. Public Utility Regulatory Policies Act of 1978 § 210(a), 16 U.S.C. § 824a-3(a) (1988).

64. *Id.*

65. "[E]ach State regulatory authority shall . . . implement such rule . . . for each electric utility for which it has ratemaking authority." *Id.* § 210(f), 16 U.S.C. 824a-3(f) (1988).

66. 18 C.F.R. § 292.401(a) (1993).

67. *Id.*

68. Policy Statement Regarding the Commission's Enforcement Role Under Section 210 of the Public Utility Regulatory Policies Act of 1978, 48 Fed. Reg. 29,475 (1983) (codified as amended at 18 C.F.R. § 292 (1983)).

rules to QF-utility disputes by state regulatory commissions has resulted in contractual adjudications by these agencies.

Assume that a state regulatory agency does not have authority under state law to adjudicate contracts either because it has not been granted that power by the state legislature or because an effort to do so has encountered a state consititutional impediment. Under that assumption, for that state agency to engage in contractual adjudication of QF-utility contracts under authority of federal legislation means that federal law has disregarded state sovereignty, reached in and either redistributed jurisdiction over substantive common law from the state courts to a state agency or displaced substantive state law by directing the state agency to apply federal common law. Even a staunch federalist would have serious reservations about the propriety of such an undertaking, especially given the lack of clear congressional intent.

If, however, it had been deliberate federal policy to preempt state substantive law and authorize QF-utility contractual adjudications by state agencies, and the policy were evidenced by clear congressional intent or a comprehensive and pervasive regulatory scheme, support might be garnered in disparate but applicable federal decisional law. Congressional delegation of contractual adjudicatory authority to FERC could find sanction in *Commodity Futures Trading Commission v. Schor*.[69] Induction of the state rate regulatory agencies into federal service and the delegation of FERC's authority to state regulatory agencies could find sanction in *Federal Energy Regulatory Commission v. Mississippi*.[70] Then, a displacement of the state common law of contracts could find sanction in *Textile Workers Union of America v. Lincoln Mills*.[71] The state regulatory agency would then be acting as a federal tribunal applying federal common law.[72] Thus, federal law (a combination of federal legislation, implementing federal regulations and federal decisional law)

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69. 478 U.S. 833 (1986) (holding that "[t]he CEA [Commodities Exchange Act] empowers the CFTC [Commodity Futures Trading Commission] to entertain state law counterclaims in reparations proceedings," and that this congressional delegation does not violate Article III).

70. 456 U.S. 742, 761-70 (1982) (holding that elements of PURPA "simply establish requirements for continued state activity in an otherwise pre-emptible field.").

71. 353 U.S. 448, 456 (1957) (concluding that "the substantive law to be applied in suits under § 310(a) [of the Labor Management Relations Act of 1947] is federal law, which courts must fashion from the policy of our national labor laws").

72. Regrettably, the Supreme Court declined the opportunity to clarify the extent to which a state rate regulatory agency could exercise independent authority under state law when federal law, PURPA, also occupied the area. The New York and Kansas rate

could provide a basis for adjudication of contracts by federal or state administrative agencies.

However, there is many a slip between the cup and the lip. Reservations regarding the soundness of *Schor*,[73] *FERC v. Mississippi*,[74] and *Lincoln Mills*[75] have been raised. Ignoring them to support state administrative agency adjudication of QF contracts might be rather troublesome. On the other hand, cascading them illuminates the total effect of the evolution of federal law affecting the adjudication of contracts by administrative agencies. That effect has been an erosion of the ideal that courts are the appropriate forum for the resolution of common law contract disputes, an erosion of the ideal that federal law cannot regulate the states as states, and an erosion of the ideal that substantive law, the common law of contracts, is the law to apply in the adjudication of contractual disputes. These matters will be discussed in the pages that follow.

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regulatory agencies had made determinations, based on state law, regarding the implementation of utility power purchases from a QF. On judicial review, the Kansas Supreme Court held that, through PURPA, Congress had preempted state law and the agency determination was not in accordance with federal law. Kansas City Power & Light v. State Corp. Comm'n, 676 P.2d 764 (Kan. 1984). The New York Court of Appeals, by contrast, affirmed the agency determination on the basis that the state law furthered the federal objective and was consistent with the overall purpose of PURPA. Consolidated Edison Co. v. Public Serv. Comm'n, 472 N.E.2d 981 (N.Y. 1984), *aff'd*, 470 U.S. 1075 (1985). The U.S. Supreme Court dismissed the appeal of the New York case for want of a substantial federal question.

73. *See* Paul M. Bator, *The Constitution as Architecture: Legislative and Administrative Courts Under Article III*, 65 IND. L.J. 233, 257 (1990) (expressing uneasiness with *Schor's* balancing away of Article III considerations); Granfinanciera S.A. v. Nordberg, 492 U.S. 33, 70 (1989) (Scalia, J., concurring) (criticizing *Schor* and the Article III standard it established). Scalia wrote:

> I do not think one can preserve a system of separation of powers on the basis of such intuitive judgments regarding "practical effects," no more with regard to the assigned functions of the courts, see *Mistretta v. United States*, 488 U.S. 361, 426-427 (1989) (Scalia, J., dissenting), than with regard to the assigned functions of the Executive, see *Morrison v. Olson*, 487 U.S. 654, 708-712 (1988) (Scalia, J., dissenting). This central feature of the Constitution must be anchored in rules, not set adrift in some multifactored "balancing test" — and especially not in a test that contains as its last and most revealing factor "the concerns that drove Congress to depart from the requirements of Article III." *Schor*, *supra*, at 851.

Granfinanciera, 492 U.S. at 70.

74. New York v. United States, 112 S. Ct. 2408, 2420-23, 2435 (1992) ("The Federal Government may not compel the states to enact or administer a federal regulatory program."); *see also* Section IV.B.

75. *See, e.g.*, Harry H. Wellington, *The Nature of Judicial Review*, 91 YALE L.J. 486, 490 n.26 (1982) (citing Alexander M. Bickel & Harry H. Wellington, *Legislative Purpose and the Judicial Process: The Lincoln Mills Case*, 71 HARV. L. REV. 1, 27 (1957) ("Congress, in responding to popular will, may unknowingly sacrifice long-range values for immediate results; such values are protected through judicial review[.]")).

III. The CPUC's Contractual Adjudicatory Authority

. . . some traditions regarding promise enforcement were quietly, unknown to many, changing . . .

A. The Problem

In 1989, the California Public Utilities Commission (CPUC) adopted two decisions expressing doubts about its adjudicatory role. Although proposed by the same administrative law judge (ALJ), these decisions revealed the frustration many ALJs of the CPUC had encountered in presiding over disputes between electric utilities, which are subject to the jurisdiction of the CPUC, and QFs, which are developers of alternative energy projects exempt from CPUC jurisdiction. The first decision said:

> Once the QF and the utility signed a contract — either one of the standard offers or a negotiated contract — we had hoped that our subsequent role would be limited to the usual review of the reasonableness of the utility's purchases and administration of its contracts with QFs. If later disputes developed between the utility and the QF about the interpretation or implementation of the contract, we presumed that the parties would turn to the common resources for resolving such disputes — negotiations, arbitration, and, if necessary, the courts.[76]

Six weeks later, the second decision repeated the above concern but was more prescriptive in its following paragraphs:

> Colmac has stated its complaint in this case in a way that was intended to fall within the limited role we have said we would assume in these disputes, and we have addressed several ancillary issues in narrowing the scope of this case. Nevertheless, it is now clear, after we have narrowed the case to its essential elements, that the primary points of the complaint boil down to disputes that frequently arise around contracts of all types and that have been addressed in several hundred years of contract law. This case turns on choosing a plausible set of facts from the different versions presented to us and apply [sic] principles of established law to those facts. Very few of the essential issues of this complaint require our special expertise to resolve; most of the issues could have been handled by the normal means of dispute resolution.
>
> At this point, having accepted the complaint, conducted the hearings, and evaluated the arguments of the briefs, we will not direct the complainant to another forum. But complainant and other parties should recognize that we have no special expertise to address the legal and equitable claims that are essential to this complaint, and our processes are neither intended nor structured to decide the detailed legal issues that are at the heart of the complaint and defense. Although we try our utmost to decide these cases correctly, our decisions typically rely more on policy concerns, fairness, and common sense than on a detailed study of pertinent legal precedents. In

76. Union Oil Co. of Cal. v. Southern Cal. Edison Co., 31 C.P.U.C.2d 338, 350 (1989).

short, we strongly recommend that contractual disputes that require resolution of narrow legal issues should be initiated in forums that are better suited to decide those issues justly and correctly.[77]

Among the issues addressed by the CPUC in these decisions were contract assignment, consent to assignment, contract modification, mutual assent, unjust enrichment, restitution, promissory estoppel, express contract, implied-in-fact contract, implied-in-law contract, good faith and fair dealing, breach of contract, reliance, repudiation, conditions, interpretation, rescission, termination, and, even while ordering the negotiation of specific amendments to the contract, "sanctity of contract."[78] Prior to these decisions, the CPUC had developed a strong tradition of adjudicating contract disputes between utilities and QFs.[79] The process was initiated either at the request of a QF, which would file its complaint against the utility at the CPUC,[80] or at the request of utilities, which would file a "petition for modification"[81] or an "application for clarification"[82] of a previous CPUC decision.

The utility approach of utilizing these de facto complaint procedures was dictated by an asymmetry in CPUC jurisdiction over these parties. There was a presumption of CPUC jurisdiction in a complaint filed against a utility.[83] By law, however, QFs were specifically

77. Colmac Energy, Inc. v. Southern Cal. Edison Co., 31 C.P.U.C.2d 549, 563 (1989).

78. *See id.* at 569. The court continues:

> Riverside also contends that public policy considerations argue against granting the requested relief. Although it appears that ratepayers would receive short-term benefits if we could cancel this contract, we believe that a greater public benefit is served by preserving the rights of parties to contract and by enforcing the parties' legally binding promises. If we were to invalidate contracts because of variations in forecasts of oil and gas prices, we would undermine the foundation of our QF program and appear to question the basis for our entire economic system.
>
> Although we played a role in developing the standard offers, we contemplated that acceptance of these offers would result in valid and binding contracts that should be enforced like any other contract. Preserving the sanctity of contracts serves a higher public policy goal, in our opinion, and outweighs the considerations listed by Riverside.

Id. at 569-70.

79. *See* Guidelines for the Administration of Power Purchase Contracts Between Electric Utilities and Qualifying Facilities, 29 C.P.U.C.2d 415 (1988) [hereinafter Contract Administration Guidelines].

80. *See* Ultrapower-Rocklin v. Pacific Gas & Elec. Co., Dec. No. 92-01-024, 1992 WL 406687 (C.P.U.C. 1992); Applied Energy, Inc. v. San Diego Gas & Elec. Co., Dec. No. 89-04-076, 31 C.P.U.C.2d 522 (1989).

81. *See, e.g.*, Pacific Gas & Elec. Co., 30 C.P.U.C.2d 677 (1989) (second application for approval of certain standard offers, also noting two petitions by PG&E for modifications); Transmission System Operation of Certain California Electric Corp., Dec. No. 92-02-014, 1992 Cal. PUC LEXIS 936 (opinion on petition for modification) [hereinafter Transmission System Operation: Midset].

82. *See, e.g.*, San Diego Gas & Elec. Co., Dec. No. 91-06-048, 1991 Cal. PUC LEXIS 375 (1991).

83. CAL. PUB. UTIL. CODE §§ 701, 702, 705, 729 (West 1975 & Supp. 1993).

exempted from CPUC jurisdiction.[84] For the same reasons, complaints against QFs by third parties took the circuitous route of a complaint against the utility that had contracted with the alleged offending QF.[85] Such a complaint would typically seek disallowance to the utility of cost reimbursement of the contract with the QF, on the basis that the utility had been imprudent in entering the contract or in not terminating it for alleged non-performance by the QF.[86]

QFs and utilities rarely took their contract complaints to the courts.[87] However, on a number of occasions the threat of doing so was used (albeit indirectly) through an elaborate fiction which resulted in a de facto adjudication of the contractual dispute. The QF and the utility would: (1) negotiate a "settlement" of their contract dispute; (2) the utility would file an "application" before the CPUC for approval of the "settlement" (usually a modified contract);[88] (3) the utility would advocate that the proposed settlement was in the ratepayer's interest because it would avoid "potential litigation" costs, with the implication that the QF had a credible threat of prevailing; (4) the CPUC would review the terms and conditions of the "settlement" (the new contract) and assess the credibility of the litigation "threat," i.e., the underlying contract dispute; and (5) approve the "settlement" or deny the "settlement" and set forth terms

84. 18 C.F.R. §§ 292.601-.602 (1993).

85. *See* Complaint of Utility Consumer's Action Network Against San Diego Gas & Electric, filed November 21, 1990, Case No. 90-11-041, *cited in* San Diego Gas & Elec., Dec. No. 91-06-048, 1991 Cal. PUC LEXIS 375 *1 (1991).

86. *Id.*

87. A few rare examples of utility-QF litigation include: Afton Energy Inc. v. Idaho Power, 729 P.2d 400 (Idaho 1986); White Current Corp. v. Vermont Elec. Coop., 609 A.2d 222 (Vt. 1992); and Pacific Energy v. San Diego Gas & Elec. Co., No. 00600047 (San Diego County Super. Ct., filed June 9, 1988) (tort issues raised). It may be the case that a filed complaint induced settlement. *See* San Diego Gas & Elec. Co., Dec. No. 93-03-058, 1993 Cal. PUC LEXIS 192 (1993); Pacific Gas & Elec. Co., Dec. No. 92-11-050, 1992 Cal. PUC LEXIS 801 (1992); San Diego Gas & Elec. Co., Dec. No. 91-09-071, 1991 Cal. PUC LEXIS 587 (1991); San Diego Gas & Elec. Co., Dec. No. 90-12-024, 1990 Cal. PUC LEXIS 1284 (1990); Pacific Gas & Elec. Co., Dec. No. 90-05-086, 1990 Cal. PUC LEXIS 295 (1990). Also, filing a complaint may have resulted in efforts to obtain preemptive administrative adjudication such as that in Transmission System Operation: Midset, *supra* note 81 (CPUC declined jurisdiction in favor of superior court).

88. *See, e.g.*, Pacific Gas & Elec. Co., Dec. No. 88-08-054, 29 C.P.U.C.2d 3 (1988) [hereinafter Crockett v. PG&E I] (application for order approving amendment of power purchase agreement); Pacific Gas & Electric Co., Dec. No. 88-09-038, 29 C.P.U.C.2d 374 (1988) [hereinafter Crockett v. PG&E II] (CPUC approved revised settlement agreement between PG&E and Crocket Cogeneration, including $12.7 million payment to QF).

and conditions of a new contract that it would approve.[89] Applications thus denied were usually "settled" again quickly with the prescribed terms and conditions and refiled with the CPUC, where they received swift approval.[90] This ritualistic process was favored by both parties, since it insulated the utility against a charge of imprudence and simultaneously guaranteed ratepayer reimbursement of contractual payments to the QF.[91] This approach became particularly favored in contract disputes that involved invocation by the QF of the "force majeure" clause in the contract between the QF and the utility.[92]

The key resolution of QF-utility contractual disputes was typically a change in favor of the utility in the price, quantity, and quality[93] of electricity that the utility was obligated to buy in exchange for an extension of time for the QF to perform.[94] Disputes regarding site relocation, fuel specifications, assignment of the contract, consent to assignment, and interconnection requirements most often served the purpose of raising the specter of unilateral termination of the contract by the utility, in order to force a modification of the price/quantity term, which is the essence of the contract. It is quite possible that, if many of these contractual differences had been judicially adjudicated, less than strict compliance by the QFs on many of these matters might have been judged immaterial breaches. Even if they were judged to be material, more than likely the QF would have been given an opportunity to cure the breach.[95] But the world of QF-

89. Pacific Gas & Elec. Co., Dec. No. 88-12-032, 30 C.P.U.C.2d 56 (1988) [hereinafter West Contra Costa] (application for order approving agreement for purchase); Pacific Gas & Elec. Co., Dec. No. 88-08-021, 28 C.P.U.C.2d 582 (1988) [hereinafter BKK] (second application for approval of standard offers pursuant to earlier decisions).

90. Crockett v. PG&E II, *supra* note 88; West Contra Costa, *supra* note 89; BKK, *supra* note 89; Pacific Gas & Elec. Co., Dec. No. 88-12-095, 30 C.P.U.C.2d 544 (1988) [hereinafter U.S. Windpower] (application for approval of agreement).

91. *See supra* note 88.

92. West Contra Costa, *supra* note 89; Crockett v. PG&E I, *supra* note 88.

93. Dispatchability, the ability to schedule electricity generation deliveries according to the needs of the utility, can be considered a "quality" variable.

94. O'Brien Energy Sys., Inc. v. Pacific Gas & Elec. Co., Dec. No. 87-11-063, 26 C.P.U.C.2d 112 (1987) [hereinafter Oil Sands Case]; Pacific Gas & Elec. Co., Dec. No. 88-03-036, 27 C.P.U.C.2d 525 (1988) [hereinafter Madera Project] (application for expedited order approving first amendment to power purchase agreement).

95. John Murray comments in his Contracts text:

> The important difference in the RESTATEMENT 2d treatment of material breach is that it does not simply distinguish between material and immaterial breaches. While it clings to the FIRST RESTATEMENT distinction between material and immaterial failures to perform by suggesting guidelines similar to its predecessor, it treats a material breach as the nonoccurrence of a condition, and it makes a further distinction between *material* breaches which may or may not be "cured."

JOHN EDWARD MURRAY JR., MURRAY ON CONTRACTS 595 (3d ed. 1990) (citations omitted). See also section 241 of the *Restatement 2d* which provides:

> In determining whether a failure to render or to offer performance is material,

utility contracts was encountering a new reality which had less to do with strict law[96] and more to do with the "unruly horse"[97] of policy.

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the following circumstances are significant:

(a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;

(b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;

(c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;

(d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981).

Professor Murray's analysis of this section continues:

> [T]he RESTATEMENT 2d suggests that where there is a material breach, there is a constructive condition to the innocent party's duty to perform that has not occurred. If, however, time remains for that condition to occur, i.e., the breaching party could still perform in a relatively timely fashion, the innocent party may not treat the failure of performance (or nonoccurrence of the condition) as a termination of his duties. Rather, the duties of the innocent party are merely *suspended* because the breaching party may perform or offer to perform in time to *cure* the material breach.

MURRAY, *supra*, at 595-96.

In determining the time after which a party's uncured material failure to render or offer performance discharges the other party's remaining duties to render performance, section 242 states that the following circumstances are significant:

(a) those stated in § 241;

(b) the extent to which it reasonably appears to the injured party that delay may prevent or hinder him in making reasonable substitute arrangements;

(c) the extent to which the agreement provides for performance without delay, but a material failure to perform or to offer to perform on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.

RESTATEMENT (SECOND) OF CONTRACTS § 242 (1981).

Professor Murray concludes that the underlying philosopy of the entire treatment of material breach under the *Restatement 2d* is:

> the pervasive concept that forfeitures are to be avoided and the concomitant view that the parties, including even a materially breaching party, are to be treated fairly. *Thus, if a breach is immaterial, neither suspension nor termination of the innocent party's duties is permitted.* He must continue to perform though he retains a cause of action for any losses he may have sustained. *Even where the breach is material, the* RESTATEMENT 2d insists upon an allowance for cure of that breach so as to prevent what may amount to a technical claim by the injured party that he has a right to treat his duties as discharged at the moment the material breach occurred.

MURRAY, *supra*, at 597 (emphasis added).

96. In *The Wallace Stevens Case*, Thomas Grey characterizes the rule of strict law as a place where "rulers and citizens alike operate under definite rules, clear commands that can be understood and applied by all, subject to ultimate enforcement only through independent judges whose primary allegiance is not to any regime or faction but

This reality was borne of a reversal in the changes that initially gave rise to the contracts. The price of oil had risen from approximately $2 a barrel in the early 1970s to $36 a barrel in the early 1980s,[98] when most QF-utility contracts were being negotiated. At the time, most informed policymakers, utilities, and QFs believed that the price path of oil would continue upward.[99] Instead, in 1986 the price of oil dropped to $10-$12 a barrel.[100]

The time for commencement of performance, that is, for the delivery of electricity to the utility, of most QF-utility contracts occurred in the late 1980s. QFs were obligated to commence delivery of electricity and utilities were obligated to commence their payments for the electricity in accordance with the terms of the contract. The QF-utility payment terms varied according to the type of contract but generally contained fixed payment terms for a significant period.[101] At the time the contracts were entered into, it was believed that generous fixed payments for a significant period during the early years of the contract were necessary to make the QF projects financable.[102]

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to the law itself." THOMAS C. GREY, THE WALLACE STEVENS CASE 87 (1991).

97. "[P]ublic policy is 'a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail.'" First Alabama Bank of Montgomery v. First State Ins. Co., Inc., 899 F.2d 1045, 1084 n.19 (11th Cir. 1990) (quoting Richardson v. Mellish, 130 Eng. Rep. 294, 303 (1824)).

98. CAL. ENERGY COMM'N BIENNIAL REPORT TO THE GOVERNOR AND THE LEGISLATURE, SECURING CALIFORNIA'S ENERGY FUTURE tab. 3-1 at 23 (1983) [hereinafter CEC BIENNIAL REPORT].

99. In early 1980, "OPEC's Long Range Strategy Committee came out with its plan for a 10 to 15 percent annual increase in oil prices, starting at the current base, which meant sixty dollars per barrel within five years." DANIEL YERGIN, THE PRIZE: THE EPIC QUEST FOR OIL, MONEY & POWER 705 (1991). This plan was entirely consistent with OPEC's pricing behavior at the time. In December 1978, OPEC announced a price increase of 5%, "effective January 1, 1979 with further increases scheduled to make the total 1979 price rise equal to 14.5 percent (or 10 percent for the yearly average increase)." ROBERT STOBAUGH, ENERGY FUTURE: REPORT OF THE ENERGY PROJECT AT THE HARVARD BUSINESS SCHOOL 29 (Daniel Yergin & Robert Stobaugh eds., 1979) [hereinafter ENERGY FUTURE]. By late 1980, the spot market price for oil reached $42. YERGIN, *supra*, at 711. Also, "In its 1981 Biennial Report the Energy Commission predicted that oil prices would increase at an approximate average of 3.3 percent per year faster than inflation in the 1981-2000 period. This average was based on a 3 percent projected increase in prices between 1981 and 1985, a 5.9% projected increase between 1985 and 1990, and a 2 percent increase between 1990 and 2000." CEC BIENNIAL REPORT, *supra* note 98, at 22.

100. "West Texas Intermediate plummeted by 70% over the next few months — from its peak of $31.75 a barrel at the end of November 1985, to $10. Some Persian Gulf cargoes sold for around $6 a barrel." YERGIN, *supra* note 99, at 750.

101. Stanley W. Hulett, *Promoting Independent Power: The California Experience*, PUB. UTIL. FORTNIGHTLY, Feb. 16, 1989, at 13; *see, e.g.*, DAVID SILVERSTONE, ESQ., ENVIRONMENTAL ACTION FOUND., PURPA PAPER NO. 5: PURPA PROVISIONS ON COGENERATION AND SMALL POWER PRODUCTION (1980); SANFORD MILLER, CALIFORNIA ENERGY COMM'N, A GUIDEBOOK ON STANDARD OFFERS FOR ELECTRIC POWER PURCHASES (1986).

102. *See* Hulett, *supra* note 101, at 14.

In exchange, the QFs accepted the long-term risk of obligating themselves to deliver electricity for an even longer period of time, with payments pegged to the price of oil at that time in a formula more favorable to the utility.[103] In other words, the QFs accepted long-term revenue and profitability uncertainty in exchange for near-term revenue and profitability certainty. The utilities accepted near-term costs for long-term benefits. The expectations of both the QFs and the utilities were based on the commonly accepted expectation of increasing oil prices in the future.

In reality, the price of oil would eventually increase again but stabilize around $15 to $18 a barrel in the late 1980s.[104] The new commonly held view of the future was that it had revealed itself and was likely to be the same. The new commonly held view of QF contracts was that they were an overly generous subsidy of private investors by the ratepayers. Consumer groups, utilities, the CPUC, and legislators were now mostly critical, and even environmentalists, who previously had been enthusiastic about alternative energy, were less tolerant of the environmental costs entailed in QF development.[105] These pressures culminated in legislative review[106] of the situation and consideration of the abrogation of these contracts through statutory or regulatory means.[107] Instead, a strict scheme of QF contract administration was devised and the CPUC increasingly delegated authority to determine contractual compliance by the QF to the other contracting party, the utility.[108] The CPUC would, of course,

103. *See, e.g., id.* at 15.

104. The collapse of the price of oil led to strong efforts by OPEC to stabilize the price of oil at $18:

> To the surprise of many, the framework of agreement managed, though with considerable reconstruction, to hold up through 1987, 1988, and 1989, though in the face of recurrent and sometimes intense pressure in the marketplace. To be sure, the OPEC price was not eighteen dollars, but rather, for the most part, in a range between fifteen and eighteen dollars.

YERGIN, *supra* note 99, at 764.

105. *See, e.g.*, CALIFORNIA ENERGY COMM'N AND CAL. PUB. UTIL. COMM'N, PROPOSED FINAL REPORT TO THE LEGISLATURE ON JOINT CEC/CPUC HEARINGS ON EXCESS ELECTRICAL GENERATING CAPACITY: SB 1970, preamble (1988) (California Legislature sponsored study into excess capacity created by QFs and how to avoid high costs associated with current QF contracts) [hereinafter PROPOSED FINAL REPORT SB 1970]; Sayles Hydro Assocs. v. Pacific Gas & Elec. Co., Dec. No. 90-12-074, 1990 Cal. PUC LEXIS 1393 (1990) (Sayles Hydro's construction of a hydroelectric facility was delayed for more than eight years due to resistance by environmentalists); *see generally* CALIFORNIA ENERGY COMM'N, AVIAN MORTALITY AT LARGE WIND ENERGY FACILITIES IN CALIFORNIA (1989).

106. PROPOSED FINAL REPORT SB 1970, *supra* note 105.

107. *Id.* at 76-112.

108. *See* Contract Administration Guidelines, *supra* note 79.

still be available to hear any complaints, petitions for modification, or applications for clarifications by the parties.

In light of the changes in energy policy at the national and state levels, the changes in the CPUC policies toward QF contracts, the increasing authority given to utilities over QF contract compliance determination by the CPUC, and the increasing number of QF contract adjudications at the CPUC with unfavorable results towards QFs, it was rather surprising that QFs had not sought the independence of review that a court might give them. Things were about to change. In March 1991, a QF indicated a preference for state court adjudication of its contractual dispute with a utility through a procedural response to a utility "application for clarification"[109] that sought a contractual interpretation that would have terminated the QF's contract.[110]

In response to the utility's "application for clarification," the QF filed a complaint in San Diego County Superior Court seeking a declaration that its contract with the utility was valid and that the rights and duties of the parties were continuing.[111] At the same time, it filed before the CPUC a motion to dismiss the "application for clarification," arguing that the CPUC lacked authority to adjudicate the legal issues, interpret the contract, or render the relief requested in the "application."[112] As an alternative motion, the QF requested a stay of the CPUC proceedings, reminding the CPUC that it was, after all, following the CPUC's direction in the two cases of 1989 (discussed above) to pursue these contractual disputes before the appropriate forum — the courts.[113] The CPUC denied the motion to dismiss but granted the alternative motion to stay the CPUC proceedings until the Superior Court issued its decision.[114]

The CPUC decision was unusually brief but rich in its implications.[115] The conclusions of law stated (1) that the Commission and

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109. San Diego Gas & Elec. Co., App. No. 90-12-064 (Cal. PUC Dec. 19, 1990), *addressed in abstract in* Utility Consumers' Action Network (UCAN) v. San Diego Gas & Elec. Co., 40 C.P.U.C.2d 626 (1991).

110. Protest by North County Resource Recovery Associates of Application 90-12-064, Application of San Diego Gas & Elec. Co. for Clarification of Decision 84-05-057 and a Determination of When the Seller Under the Contract Approved in D.84-05-057 Must Commence Operation (C.P.U.C. 1991) (App. No. 90-12-064).

111. Complaint for Declaratory Relief, North County Resource Recovery Assocs. v. San Diego Gas & Elec. Co. (San Diego County Super. Ct. 1991) (No. 634642).

112. Motion of North County Resource Recovery Associates to Dismiss Application 90-12-064 or, in the Alternative, to Stay All Proceedings and Determinations Thereon at 2-10, Application of San Diego Gas & Elec. Co. for Clarification of Decision 84-05-057 and a Determination of When the Seller Under the Contract Approved in D.84-05-057 Must Commence Operation (C.P.U.C. 1991) (App. No. 90-12-064).

113. *Id.* at 18-19.

114. Utility Consumers' Action Network (UCAN) v. San Diego Gas & Elec. Co., 40 C.P.U.C.2d 626 (1991).

115. *Id.*

the courts have concurrent jurisdiction to resolve contract disputes between utilities and QFs, (2) that the court has the additional power to award damages arising out of the contract dispute, and (3) that the Commission may elect not to exercise its jurisdiction.[116]

The first conclusion of law raises the question of whether the Commission's jurisdictional authority is as coextensive as the Commission suggests. The second conclusion of law raises the question of whether there is a constitutional impediment to the adjudication of contract disputes by the CPUC even if it remained within its statutorily limited remedial jurisdiction. The third conclusion of law raises the question of whether administrative restraint by the CPUC, in its primary jurisdiction tug-of-war with the courts and in its regulatory oversight of the utilities, would be more consistent with the law as well as promotive of the beneficial effects of reducing regulatory intrusion in the marketplace.

B. *State-Derived Authority*

Contracts between private regulated utilities and private unregulated generators of electricity form a particular class of private contracts.[117] Disputes between parties to private contracts present questions of common law which normally are adjudicated before

116. *Id.*

117. This article focuses on contracts between privately-owned electric power utilities and privately-owned non-utility power generators. *See supra* note 14. Privately-owned electric power utilities, usually referred to as investor-owned utilities (IOUs), are financed by their shareholders and bondholders and organized as corporations or holding companies. The privately-owned non-utility power generators, usually referred to as QFs, for reasons addressed in Section II, *supra*, of this article, are generally financed by private parties in their personal or corporate capacity and usually organized into limited partnerships for purposes of project financing, management, and ownership. The investor-owned utilities are subject to rate-of-return regulation by a state regulatory authority, usually a public utility commission or a public service commission. QFs are exempt from such regulation.

Approximately 250 investor-owned electric utilities supply 80% of the electricity needs of the United States. *See* JOSEPH P. TOMAIN ET AL., ENERGY LAW AND POLICY 445-489 (1989); PAUL L. JOSKOW & RICHARD SCHMALENSEE, MARKETS FOR POWER: AN ANALYSIS OF ELECTRICAL UTILITY DEREGULATION 11-23 (1983). For information on regulation of their rate-of-return, see JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES (2d ed. 1988); CHARLES F. PHILLIPS, JR., THE REGULATION OF PUBLIC UTILITIES (2d ed. 1988); EDWARD E. ZAJAC, FAIRNESS OR EFFICIENCY: AN INTRODUCTION TO PUBLIC UTILITY PRICING (1978).

On the other side of this contractual transaction are approximately 4400 non-utility power generators. *See* FERREY, *supra* note 17, at 3-1 to 3-70.

state courts.[118] When diversity is present, such disputes may be adjudicated by federal courts applying the common law of the state of the appropriate jurisdiction.[119] Contract disputes between a private party and a government entity are public contracts which may, by an act of the appropriate legislative body, be adjudicated by an administrative agency.[120] Under limited circumstances an administrative agency can adjudicate private contract disputes.[121] It has been held, however, that in such circumstances a federal agency must apply state contract law.[122] Needless to say, in such circumstances a

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118. Kessler and Gilmore explain the role of the common law in the United States court system:

> In the creation of the law of contracts the courts have played a decisive role both here and in England. Our federal system of government granted almost complete control over private law to the states. Since their legislatures failed to play a major role in developing a body of private law, the job remained for the courts. However powerful the forces working toward uniformity, the ideal of a "general law" (of contracts) was never fully realized; and each jurisdiction remained free to develop its own case law.

FRIEDRICH KESSLER & GRANT GILMORE, CONTRACTS 13 (2d ed. 1970); *see also* K.N. Llewellyn, *On Our Case Law of Contract: Offer and Acceptance, I*, 48 YALE L.J. 1, 1-9 (1938).

119. 28 U.S.C. § 1331 (1984); *see* Erie R.R. v. Tompkins, 304 U.S. 64 (1938); Pennzoil Co. v. Federal Energy Reg. Comm'n, 645 F.2d 360 (5th Cir. 1981). The *Pennzoil* Court stated:

> This Court . . . holds that specific determinations of contractual authority in the protest procedures must take account of and follow any differences with general contract law that the appropriate state contract law may have.
>
> This holding is a direct result of the application of the doctrine in *Erie Railroad v. Tompkins* . . . . Because of the unfairness in applying two different, conflicting standards to the same conduct, and the incentive for forum shopping that a differing federal and state rule would create, in a scheme of limited federal and reserved state powers, state substantive law remains the rule of decision unless federal law has preempted that substantive rule.

Id. at 383-84 (citation omitted).

120. *See* McHugh v. Santa Monica Rent Control Bd., 49 Cal. 3d 348, 777 P.2d 91, 261 Cal. Rptr. 318 (1989); Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

121. *Schor*, 478 U.S. at 833.

122. As the *Pennzoil* court points out, even federal preemption does not mandate application of a federal common law of contracts:

> Nor does *Erie* apply only to federal court diversity jurisdiction. The federalism concern of *Erie* is applicable to every federal tribunal when federal substantive law has not expressly or impliedly displaced the state substantive law on the particular question for decision.
>
> . . . The very evil that *Erie* addressed would arise if FERC followed one substantive rule while state courts followed another: parties whose contracts are within concurrent FERC and court jurisdiction would be subject to two different rules for the same conduct, and each would have an incentive to have their contract interpreted in the forum applying the rule most favorable to that party. *Erie* achieves not uniformity of result, since identical language can carry different contractual intent depending on the circumstances, but instead uniformity of applicable law. No matter which forum the interpretation is made in, the same body of law —either state or federal — would apply.

Pennzoil, 645 F.2d at 384.

state agency must apply the law of the state.[123] Therefore, whether or to what extent the CPUC may adjudicate QF utility contractual disputes begins with an inquiry into the relative powers of the California courts and the CPUC to adjudicate contracts in general.

The powers of the California courts are set forth in the California Constitution and enabling statutes. The Constitution provides, "The judicial power of this State is vested in the Supreme Court, courts of appeal, superior courts, municipal courts, and justice courts."[124] The California Code of Civil Procedure grants original jurisdiction over breaches of contract to the municipal courts when the amount in controversy is less than $25,000[125] and to the Superior Court if it is more than that amount. The Public Utilities Code provides that an action to recover for loss, damage, or injury caused by a utility may be brought in any court of competent jurisdiction. In addition to actual damages, the court is authorized to award exemplary damages for willful acts.[126] Finally, the declaratory judgment provisions of the California Code of Civil Procedure allow an original action to be brought in Superior Court for "a determination of any question of construction or validity arising under [a] . . . contract."[127] Therefore, there is express authority for jurisdiction by the courts for the adjudication of contract disputes.

There is no such express authority for similar jurisdiction by the CPUC. Jurisdiction by the CPUC over contract disputes has, however, been implied by judicial decisions construing the constitutional and legislative provisions granting the CPUC the authority to fix rates, award reparations, and do all things necessary and convenient in the exercise of its power.[128] Such jurisdiction is, however, limited

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123. One remaining permutation does exist in the adjudication of private contracts — a state administrative agency applying "federal common law." This could occur through a combination of federal preemption of state contract law, accompanied by a federal mandate to a state agency that it adjudicate contractual disputes arising under the preempting federal law.

124. CAL. CONST. art. VI, § 1.

125. CAL. CIV. PROC. CODE § 86 (West 1994).

126. CAL. PUB. UTIL. CODE § 2106 (West 1975).

127. CAL. CIV. PROC. CODE § 1060 (West 1980).

128. *See, e.g.*, Motor Transit Co. v. Railroad Comm'n, 189 Cal. 573, 581, 209 P. 586, 589 (1922) ("The fact that an order of the commission given in pursuance of the commission's power and under the commission's duty to regulate public utilities . . . incidentally requires the petitioners to do an act which carries out the terms of a private contract, does not . . . operate to divest the commission of its jurisdiction."); Pacific Tel. & Tel. Co. v. Public Util. Comm'n, 34 Cal. 2d 822, 829, 215 P.2d 441, 445 (1950) ("[T]he commission's control over contracts affecting rates and services is limited to regulation of contracts that directly affect the service the rate-payer will receive at a particular rate."). The CPUC recognizes this limitation. *See, e.g.*, Pacific Tel. & Tel. Co., Dec.

and strictly ancillary to its primary regulatory functions.[129]

Analysis of the CPUC's adjudicatory authority over contracts begins with the establishment of the Railroad Commission by constitutional amendment in 1879.[130] Subsequent amendments to the California Constitution broadened the commission's authority to include jurisdiction over all public utilities (including electric utilities) and its redesignation as the Public Utilities Commission.[131] The Constitution also provided that, "[T]he Legislature has plenary power . . . to confer additional authority and jurisdiction upon the commission . . . [and] to establish the manner and scope of review of commission action in a court of record."[132] The legislature did so by providing, among other things, that the CPUC "may do all things . . . which are necessary and convenient in the exercise of [its] power and jurisdiction."[133]

The Constitution specifically grants the CPUC the authority to award reparations from transportation companies.[134] In addition, the legislature has granted the CPUC statutory authority to award reparations from any public utility.[135] The power to award reparations is, in the context of the exercise of the regulatory authority of the CPUC, the power to return overcharges,[136] the equitable remedy of restitution. Therefore, the CPUC can exercise equitable remedial authority, a judicial power. There has been judicial recognition that the CPUC can exercise other equitable powers, such as injunctions in aid of jurisdiction conferred upon it,[137] ordering creation of a trust fund,[138] and issuing cease and desist orders.[139]

The court has extended the CPUC's equitable remedial authority

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No. 83-09-024, 12 C.P.U.C.2d 525, 564 (1983) ("The Commission has authority to prescribe the terms of contracts which directly affect the service a ratepayer will receive."); ICS Communications, Dec. No. 83-05-013, 11 C.P.U.C.2d 421, 423 (1983) ("It is fundamental that this Commission is vested with jurisdiction in all reparation cases and its jurisdiction is not affected by the fact that interpretation of contracts may be involved.").

129. *See infra* note 141; *see, e.g.*, Consumers Lobby Against Monopolies v. Public Util. Comm'n, 25 Cal. 3d 891, 603 P.2d 41, 160 Cal. Rptr. 124 (1979).

130. CAL. CONST. art. XII, §§ 17-24.

131. *Id.* §§ 1-9.

132. *Id.* § 5.

133. CAL. PUB. UTIL. CODE § 701 (West Supp. 1992).

134. CAL. CONST. art. XII, § 4 ("The commission may . . . award reparation for the exaction of unreasonable, excessive, or discriminatory charges.").

135. CAL. PUB. UTIL. CODE § 734 (West Supp. 1992).

136. The California Supreme Court has concluded that the CPUC's reparation authority includes demanding the collection of *undercharges* by utilities. Consumers' Lobby Against Monopolies v. Public Util. Comm'n, 25 Cal. 3d 891, 908, 603 P.2d 41, 51, 160 Cal. Rptr. 124, 134 (1979).

137. Kern County Land Co. v. Railroad Comm'n, 2 Cal. 2d 29, 38 P.2d 401 (1934); Motor Transit Co. v. Railroad Comm'n of Cal., 189 Cal. 573, 209 P. 586 (1992) (en banc).

138. People v. Superior Court, 62 Cal. 2d 515, 399 P.2d 385, 42 Cal. Rptr. 849 (1965).

139. Regulated Carriers, Inc. v. Farnham, 39 Cal. R.R. Comm'n. 323 (1935).

as far as to include the award of attorney's fees in adjudicatory proceedings under the common fund doctrine.[140] But even though the CPUC can exercise broad equitable remedial powers, its authority to do so is not coextensive with the courts' when it comes to the adjudication of contractual disputes.[141] In fact, the CPUC's authority to adjudicate contracts is narrowly circumscribed.[142]

In order to ascertain the limitations on the CPUC's authority to adjudicate contracts, we need to consider constituent determinations in the resolution of a typical contract dispute. We will then inquire whether the CPUC has the authority to make these determinations. Typically, the resolution of a contract dispute may involve the determination of the existence and validity of a contract, the interpretation of a contract, the determination of performance or breach, and the fashioning of a remedy, including, possibly, the reformation or modification of a contract.

Of these elements, the brightest line comes with the CPUC's remedial authority. There is no authority for the CPUC to award the legal remedy of compensatory damages. However, we have already seen that the constitutional and statutory scheme explicitly allows the CPUC to award the equitable remedy of reparations. But despite the many amendments to the Constitution[143] and the Public Utilities Code,[144] the CPUC has never been authorized to award damages.[145] The CPUC has respected this limitation and has interpreted its own

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140. *See infra* note 141.

141. See Consumers' Lobby Against Monopolies v. Public Util. Comm'n, 25 Cal. 3d 891, 906, 603 P.2d 41, 50, 160 Cal. Rptr. 124, 133 (1979), which explains:

> "[W]hile it is true that the commission is not a judicial tribunal in a strict sense, it does not follow that it does not possess well established and well understood judicial power." Of course, the commission's judicial powers are not coextensive with those exercised by courts. There is, nevertheless, a significant coincidence of powers between the two, including those that are equitable in nature.

Id. (citations omitted); *see, e.g.*, Camp Meeker Water Sys., Inc. v. Public Util. Comm'n, 51 Cal. 3d 845, 850, 799 P.2d 758, 760, 274 Cal. Rptr. 678, 680 (1990).

142. *See infra* notes 166-77 and accompanying text.

143. Despite revision of Article XII of the California Constitution, the CPUC never has been given the power to award damages. The current version of the Constitution addressing the Commission's power to award reparations is essentially the same as the Constitution of 1911. *See, e.g.*, CAL. CONST. art. XII, § 9.

144. The Public Utilities Code has often been amended. However, the CPUC's jurisdiction and remedial authority has remained rather constant.

145. Though the power to award reparations seems limiting to present regulatory authority, it should be kept in mind that early regulatory commissions only had the power to fix rates. Only the courts could award reparations. In time, state legislatures granted regulatory commissions the power to award reparations. *See, e.g.*, Southern Pac. Co. v. Railroad Comm'n, 194 Cal. 734, 231 P. 28 (1924). The fact that the Railroad

authority to exclude the power to award damages.[146]

The remainder of the constituent determinations mentioned above have a common base in equity.[147] Consequently, it is theoretically possible for the courts to develop an expansive view of the CPUC's authority to adjudicate these constituent elements under the authority of the CPUC's equitable powers, as it did in *Consumers' Lobby Against Monopolies* (when it gave the CPUC the authority to award attorney's fees under the common fund doctrine).[148] However, the courts have declined to do so.

Even while extending the CPUC's equitable powers, the court has recognized that, "the commission's judicial powers are not coextensive with those exercised by courts," and that the commission "exercises equitable jurisdiction as an *incident* to its express duties and authority."[149] Both the court's and the CPUC's interpretations have been consistent in strictly limiting the CPUC's authority to exercise equitable powers in making any of the elemental determinations mentioned above.

To begin with, the determination of the existence and validity of a contract, the interpretation of a contract, the reformation or modification of a contract, or the determination of performance and breach without an accompanying damage remedy (which we have already seen the CPUC cannot render), essentially would be a declaration of the rights and duties of the parties. As previously mentioned, Section 1060 of the California Code of Civil Procedure grants the Superior Court original jurisdiction over declaratory judgments.[150]

Commission was constitutionally granted the power to award reparations from its inception should impress upon us that this was considered a significant and expansive grant of authority at that time. In light of this, it is likely that extending the grant of authority to include the power to award damages was considered unnecessary or perhaps an inconceivable incursion into judicial authority.

146. *See* Consumers' Lobby Against Monopolies, Dec. No. 88533, 83 C.P.U.C. 484 (1978); Mak v. Pacific Tel. & Tel., 72 C.P.U.C. 735 (1971); Horwitz v. Pacific Tel. & Tel., 72 C.P.U.C. 505 (1971).

147. A declaration of rights and duties is an equitable remedy.

148. Consumers' Lobby Against Monopolies v. Public Util. Comm'n, 25 Cal. 3d 891, 897, 603 P.2d 41, 44, 160 Cal. Rptr. 124, 127 (1979). The general rule is that a party can be awarded attorney's fees if there is specific authorization by statute or private agreement. The CPUC had no such authorization but the court, in affirming the award, relied heavily on the CPUC's general equitable powers to extend the common fund doctrine to adjudicatory proceedings in reparation actions.

149. *Id.* at 906-07, 603 P.2d at 50, 160 Cal. Rptr. at 133 (emphasis added).

150. The California courts had in fact been rendering declaratory judgments almost as soon as they were established, long before the legislature adopted Section 1060 in 1921:

> Before England had adopted any of its modern legislation upon the subject, our Practice Act of 1850 had been enacted with the provision now appearing in our Code of Civil Procedure, to the effect that an action might be brought "by one person against another for the purpose of determining all adverse claims which the latter makes against the former for money or property upon an alleged obligation;" and in the fifth volume of our reports you will find an instance

There is no such express grant to the CPUC, nor has any court decision implied such authority. But there also has been no court decision which has ruled directly that the CPUC has no authority to render declaratory relief. The CPUC has, however, consistently eschewed any such authority.[151] For example, when a telephone company filed a motion asking the CPUC if its proposed contract was consistent with an ordering paragraph of a previous decision, the CPUC said the motion sought a declaratory order, and the CPUC does not accord such relief by issuing declaratory opinions.[152] The CPUC recently ruled directly on point in a dispute involving a contract between a QF and a utility.[153] In that dispute the utility sought a contract interpretation and modification. The CPUC ruled that the requested action by the utility "would amount to declaratory relief, and the Commission has held that it does not grant declaratory relief."[154]

In another part of the decision, the CPUC appeared to hedge its bets and reserve the possibility that it could render declaratory relief by stating that "[t]he Commission *generally* does not grant declaratory relief."[155] Its only conclusion of law also seemed to reserve such power when it stated that "[t]he subject matter of this application is not so significant nor is Commission policy at stake to require the Commission to depart from its general rule that it does not issue advisory opinions."[156] Previously, in the body of the opinion, the CPUC had noted that, "the Commission has not always refrained

> where an action was maintained under this provision to have it determined that the plaintiff was not indebted to the defendant upon a promissory note. But our declaratory judgments have not been confined to actions brought under this statute. . . . The judgment in all of these various proceedings is a final determination of the rights of the parties and they are forever bound by its terms; but beyond this determination the judgment does not go; and neither the sheriff nor the losing party is required to act in order to carry the judgment into effect. This is the essence of the declaratory judgment.

Maurice E. Harrison, *California Legislation of 1921 Providing for Declaratory Relief*, 9 CAL. L. REV. 359, 362-63 (1921).

151. Athearn Transp. Consultants, Inc. v. ANR Freight Sys. Inc., 26 C.P.U.C.2d 104 (1987); Bay Freight Lines, 71 C.P.U.C. 503 (1970); Moore Truck Lines, 69 C.P.U.C. 351 (1969).

152. General Tel. Co. of Cal., 32 C.P.U.C.2d 168 (1989).

153. San Diego Gas & Elec. Co., Dec. No. 91-11-045, 1991 Cal. PUC LEXIS 650 (1991).

154. *Id.* at *5.

155. *Id.* at *1 (emphasis added).

156. *Id.* at *8 (Commission referred to declaratory relief and advisory opinion interchangeably).

from issuing advisory opinions."[157] However, the only citation in the opinion presumably supporting its reservation of authority to issue an advisory opinion, *Southern California Edison*,[158] does not support the proposition that the CPUC could issue a declaratory judgment to resolve a contract dispute.

In *Southern California Edison*, the utility had made an unnecessary application for a certificate to construct a power plant.[159] The application was unnecessary because it involved a category of power plants that had been exempted by a CPUC General Order.[160] The utility was seeking "preliminary" assurances that the project costs of an experimental geothermal plant were appropriately apportioned between the shareholders and the ratepayers.[161] The Legal Division challenged the propriety of the application, in part because it essentially was a request for an advisory opinion.[162] The Commission rejected the Legal Division's arguments, accepted the application, and concluded that the project's benefits did not outweigh the negative economic impacts on ratepayers.[163] It further concluded that the project was not a reasonable and prudent investment for the utility or its ratepayers and that it was not in the public interest. The application was therefore denied.[164]

The case, however, is not on point. The application did not seek resolution of a contractual dispute. It did not even seek the resolution of an "adjudicatory" proceeding. Adjudication looks to the past with a view toward remedying primarily private injury and is judicial in nature. This decision instead resolved a matter with future implications for all ratepayers in Southern California Edison's service area. It does not provide support for the proposition that the CPUC has interpreted its own adjudicatory authority to include declaratory relief in a contractual dispute generally or specifically between a utility and a QF.[165]

Review of court decisions regarding the authority of the CPUC to

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157. *Id.* at *8.

158. Southern Cal. Edison, 6 C.P.U.C.2d 117, 136 (1981), *construed in* San Diego Gas & Elec. Co., 1991 Cal. PUC LEXIS 650 at *8 ("In determining whether or not to entertain an application which is not prescribed by law, the Commission can exercise wide discretion in weighing the importance of the subject matter, the availability of resources, time constraints, etc.").

159. *Southern Cal. Edison*, 6 C.P.U.C.2d at 119.

160. *Id.*

161. *Id.* at 119-20.

162. *Id.* at 130.

163. *Id.* at 136-42.

164. *Id.* at 142.

165. In fact, there is a good policy argument, to be taken up in Section VI.B, *infra*, that the CPUC should have heeded the Legal Division's advice and dismissed the application. Since the Commission denied the application anyway, it would have had the same effect, for all practical purposes, and not left the CPUC with a precedent apparently confusing to some.

make a determination of the existence and validity of a contract, interpret a contract, reform or modify a contract, or determine performance or breach of a contract indicates that such authority is tightly circumscribed. In *Camp Meeker Water Systems, Inc. v. Public Utility Commission*,[166] the court concluded, that "in the exercise of its ratemaking authority," the CPUC may construe deeds conveying real property.[167] The court held that such interpretation of a deed was constitutionally and statutorily permissible because it was a "necessary incident" to the CPUC's consideration of an application for an increase in its charges.[168]

The court's decision was, however, quite illuminating in regard to the CPUC's acknowledgments of the limitations on its interpretive authority. The court stated that "[t]he commission acknowledges that it does not have jurisdiction equivalent to that of a court, to adjudicate incidents of title, and that it would be bound by a judicial ruling in a quiet title action brought by any person claiming an interest in the subject property who believes the commission ruling clouds his title."[169] The court stated in essence that the CPUC had the authority to make an equitable determination, similar to a declaratory judgment, regarding the rights and duties of parties to a contract involving property, solely for the purpose of, and without consequence for anything other than, fixing rates. The court explained that the CPUC was disclaiming any power to make new rights.[170] The court also stated:

> The commission expressly recognizes that its functions *do not include determining the validity of contracts, whether claims may be asserted under a contract*, or interests in or title to property . . . . It claims only the power to construe, for purposes of exercising its regulatory and ratemaking authority, the existing rights of a regulated utility.[171]

This latter CPUC limitation has run almost from the moment the CPUC was granted its broad grant of authority over *all* public utilities, as defined in the 1911 amendments to the Public Utility Code.[172] In a contract made before those amendments took effect, a condition that the transfer of possession would be dependent upon

166. 51 Cal. 3d 845, 799 P.2d 758, 27 Cal. Rptr. 678 (1990).
167. *Id.* at 850, 799 P.2d at 760, 27 Cal. Rptr. at 686.
168. *Id.*
169. *Id.* (citation omitted).
170. *Id.* at 767.
171. *Id.* (emphasis added) (citations omitted).
172. *See* CAL. PUB. UTIL. CODE § 701 (Deering 1990) and notes on historical derivation.

permission from the then-Railroad Commission was placed in a contract for sale of a water system.[173] The buyer applied to the Commission for such approval.[174] The seller changed his mind, sold the water system to the City of Los Angeles and applied for approval of that sale.[175] In the end, the buyer's application was dismissed, the seller's application for approval to sell to the City of Los Angeles was approved, and the buyer filed for a writ of mandamus to compel the Commission to rule on his application — in other words, on the validity of his contract.[176] The court said the Commission had no "power to determine whether a valid contract of sale exists, or whether either party has a legal claim against the other under such a contract. These are questions for the courts, and not for the railroad commission . . . ."[177] The court has reaffirmed this conclusion numerous times.[178] Many CPUC rulings agree with this conclusion as well.[179] In *Sunland Refining Corporation*,[180] the CPUC held: "The interpretation of the contract and the enforcement of the remedies thereunder is properly a function of the civil court. The Commission is not charged with the enforcement of private contracts."[181]

In summary, the courts have express constitutional and statutory jurisdiction to adjudicate all legal and equitable matters regarding contract disputes.[182] The CPUC does not have any such express authority.[183] The courts have, however, recognized limited, implied equitable powers for the CPUC to adjudicate some contractual matters that are necessarily incident to and whose determination is to be used solely for the effectuation of the CPUC's authority to fix rates.[184] The courts have repeatedly held, and the CPUC has repeatedly confirmed, that the adjudication of any other contractual disputes and the award of any remedy for breach of contract other than

173. Hanlon v. Eshleman, 169 Cal. 200, 146 P. 656 (1915).
174. *Id.* at 202, 146 P. at 656.
175. *Id.* at 202, 146 P. at 656-57.
176. *Id.*
177. *Id.* at 203, 146 P. at 657.
178. Atchison, Topeka & Santa Fe Ry. Co. v. Railroad Comm'n, 173 Cal. 577, 582, 160 P. 828, 830 (1916) ("[T]he railroad commission is not a body charged with the enforcement of private contracts."); California Water & Tel. Co. v. Public Util. Comm'n, 51 Cal. 2d 478, 488, 334 P.2d 887, 893 (1959) (CPUC cannot modify public utility's contract).
179. *See* Nacimiento Water Co., Dec. No. 92-10-034, 1992 Cal. PUC LEXIS 898 (1992); API Alarm Sys. v. General Tel. Co. of Cal., Dec. No. 88-12-036, 30 C.P.U.C.2d 94 (1988); Carmel Mountain Ranch, Inc. v. San Diego Gas & Elec. Co., Dec. No. 88-03-024, 1988 Cal. PUC LEXIS 67 (1988); The Windmill, Inc. v. Alco Transp. Co., Dec. No. 86-05-044, 21 C.P.U.C.2d 142 (1986).
180. Sunland Refining Corp., 80 C.P.U.C. 806 (1976).
181. *Id.* at 816.
182. *See supra* notes 124-27 and accompanying text.
183. *See supra* notes 128-29 and accompanying text.
184. *See supra* notes 130-40 and accompanying text.

reparations is solely within the judicial power of the courts.[185]

C. *Federally-Derived Authority*

The CPUC has, however, made the claim that it has authority to adjudicate QF-utility contracts based on federal statutory law. In a recent court challenge to a CPUC decision (which, among other things, effectively modified existing QF-utility agreements), the CPUC argued:

> The CPUC's authority to approve the monitoring program in the context of contract administration derives from Section 210(f) of PURPA and the related regulations of the Federal Energy Commission (FERC) (18 C.F.R. [Sections] 292.301 *et. seq.* and 292.401).[2] [citation is to 18 C.F.R. Sec. 292.304(e)(iii)] Congress understood the complexity of overseeing the power purchase arrangements between QFs and the public utilities under the ratemaking jurisdiction of the individual states. In Section 210(f) of PURPA, therefore, and in FERC's related regulation, 18 C.F.R. Sec. 292.401, the implementation of FERC's basic rules are delegated to the states, including the issuance of regulations, *resolution of contract disputes*, and setting rates for purchases.
>
> The CPUC Order is, therefore, well within the authority delegated to the states in Section 210 of PURPA. If Plaintiffs want to enjoin the efficiency monitoring programs or challenge *the modification of avoided cost payments, as provided in the CPUC Order*, they must look within Section 210 for their judicial review options.[186]

We will now analyze that contention. Before we begin, it would be useful to keep in mind that, as evidenced in the above Order, the CPUC interprets the phrase "delegation to the states" to mean a delegation to the CPUC. This interpretation is valid with respect to some PURPA matters, such as setting avoided cost rates, but it is ambiguous as to whether the federal delegation to the states also included authority, beyond that permitted by state law, for the CPUC to adjudicate contract disputes.

On April 18, 1977, shortly after his election as President of the United States, Jimmy Carter spoke to the nation regarding the "energy crisis" that had developed subsequent to the oil embargo of 1973.[187] He said failure to act soon would transform the "energy crisis" to an "economic, social, and political crisis that will threaten our free institutions."[188] President Carter told the nation that the

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185. *See supra* notes 141-79 and accompanying text.
186. Response of the California Public Utilities Commission to Plaintiff's Memorandum on Subject Matter Jurisdiction at 4-5, Independent Energy Producers Assn. v. California Pub. Util. Comm'n, 1992 WL 533058 (N.D. Cal. 1992) (No. C-91-2644-MHP) (emphasis added) [hereinafter Memo on Subject Matter Jurisdiction].
187. President's Address to the Nation, 13 WEEKLY COMP. PRES. DOC. 560 (1977).
188. *Id.* at 562.

effort necessary to prevent this would require "the moral equivalent of war."[189]

Congress was enlisted in this effort and the Carter presidential years, brief as they were, resulted in significant legislative intervention in the economy, directed at various aspects of the "energy crisis."[190] Some of the legislation has been repealed, some has expired and much has been significantly amended. However, PURPA of 1978, one of the most far-reaching legislative products of the Carter years, remains in force essentially unchanged.[191] Its goals included enhancing energy security[192] by lessening the nation's dependence on fossil fuels through energy conservation, energy efficiency, and non-utility energy production.[193]

Most pertinent to our inquiry is Section 210 of PURPA.[194] Through Section 210, Congress required electric utilities to purchase

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189. *Id.* at 561.

190. President Carter centralized energy policy making by creating a Cabinet-level department, the Department of Energy. 42 U.S.C. §§ 7111-7112 (1988 & Supp. 1993). Carter oversaw passage of the National Energy Act of 1978 which was comprised of five major pieces of legislation — the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117; The Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174; the National Energy Conservation Policy Act, Pub. L. No. 95-619, 92 Stat. 3206; the Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289; and the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350. Later in his term President Carter proposed, and Congress approved, the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229; the Wind Energy Systems Act of 1980, Pub. L. No. 96-345, 94 Stat. 1134; and the Energy Security Act, Pub. L. No. 96-294, 94 Stat. 611, which was also comprised of five major pieces of legislation — the Defense Production Act Amendments of 1980, Pub. L. No. 96-294, 94 Stat. 617; the United States Synthetic Fuels Corporation Act of 1980, Pub. L. No. 96-294, 94 Stat. 633; the Biomass Energy and Alcohol Fuels Act of 1980, Pub. L. No. 96-294, 94 Stat. 683; the Solar Energy and Energy Conservation Bank Act, Pub. L. No. 96-294, 94 Stat. 719; the Geothermal Energy Act of 1980, Pub. L. No. 96-294, 94 Stat. 763; and the Acid Precipitation Act of 1980, Pub. L. No. 96-294, 94 Stat. 770.

191. Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (codified as amended in scattered sections of 5, 15, 16, 26, 30, 42 & 43 U.S.C. (1988)) [hereinafter PURPA].

192. United States imports of foreign oil increased from 23% of total domestic oil consumption in 1970 to between 45% and 50% in 1977. H.R. REP. NO. 543, 95th Cong., 2d Sess. 5 (1977).

193. 16 U.S.C. § 2601 (1988). Titles I and III of PURPA shared three goals: (1) the encouragement of conservation of energy supplied by utilities; (2) the optimization of energy efficiency in the production and delivery of energy by utilities; and (3) the promotion of changes in rate design that would encourage energy efficiency and conservation by utilities and their customers. Title II sought to stimulate the production of energy (electricity and steam) by non-traditional fuels and technologies. *See* PURPA, *supra* note 191.

194. *See* PURPA § 210, *supra* note 12.

electric energy from[195] and sell electric energy to qualifying cogeneration and small power production facilities (QFs)[196] at non-discriminating rates that would be just and reasonable and in the public interest.[197] Congress generally exempted such qualifying facilities from federal and state regulation that otherwise would be applicable to them as an "electric utility" under the Federal Power Act, the Public Utility Holding Company Act, and state rate-of-return regulation.[198] Finally, Congress directed FERC to prescribe the necessary rules.[199] FERC implemented Section 210 of PURPA by adopting the necessary regulations in 1980,[200] including regulations implementing the congressional intent that "after any rule is prescribed by the Commission . . . each State regulatory authority [SRA] shall . . . implement such rule . . . for each electric utility for which it has ratemaking authority."[201]

The rules developed by FERC were quite specific with respect to some matters, such as the criteria for qualifying small power production facilities,[202] the criteria for qualifying cogeneration facilities,[203] and the criteria for ownership.[204] With respect to other matters, however, the FERC rules permitted varying degrees of discretion. For example, although FERC directed that each electric utility shall purchase any energy and capacity which is made available from a

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195. 16 U.S.C. § 824a-3(b) (1988). The purchase rate could not exceed the incremental cost to the utility of alternative electric energy. "Incremental cost of alternative electric energy" was defined as "the cost to the electric utility which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." 16 U.S.C. § 824a-3(d) (1988).

196. Qualifying small and cogenerating power production facilities are those facilities that meet the criteria set forth by the FERC in 18 C.F.R. §§ 292.204-.205 (1993). For cogeneration facilities the principal criterion is a minimum standard of thermal efficiency. For small power production facilities the criteria are maximum size (80 megawatts) and fuel type (biomass, waste, renewable resources, and geothermal resources). Both types of facilities have an ownership test that prohibits majority ownership by a person primarily engaged in the generation or sale of electric power (other than from other cogeneration or small power production facilities). 18 C.F.R. § 292.206(a) (1993).

197. 16 U.S.C. § 824a-3(b)(1) (1988).

198. *Id.* § 824a-3(g)-(h).

199. *Id.* § 824a-3(h).

200. 18 C.F.R. §§ 292.101-.602 (1993). For a useful summary, see DAVID SILVERSTONE, ENVIRONMENTAL ACTION FOUND., PURPA PAPER NO. 5: PURPA PROVISIONS ON COGENERATION AND SMALL POWER PRODUCTION (1980).

201. 16 U.S.C. § 824a-3(f)(1) (1988).

202. 18 C.F.R. § 292.204 (1993).

203. *Id.* § 292.205.

204. *Id.* § 292.206.

qualifying facility,[205] it gave the qualifying facility the option of either providing "energy as the qualifying facility determines such energy is available"[206] or "pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term."[207]

FERC contemplated that, under the latter option, qualifying facilities would enter into contracts with the purchasing electricity utility. Use of the term "legally enforceable obligation"[208] was, however, intended to prevent a utility from "circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility."[209]

The greatest discretion provided by FERC in its rules was, however, delegating power to the states to determine the rates for purchases, essentially the price term of the contract between the parties. FERC's rules state that rates for purchases shall be just and reasonable, non-discriminatory, and at "avoided cost."[210] FERC recognized that any contracts based on avoided costs were likely to be contracts based on estimates and that, as a result, experienced

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205. *Id.* § 292.203(a). Capacity and energy are the two components of electricity that are commercially bought and sold. Capacity is purchased in power units — watts; energy is purchased in power unit-hours — kilowatt-hours. Typically in these contracts, one is dealing in megawatts (one million watts) and megawatt-hours.

206. *Id.* § 292.304(d)(1).

207. *Id.* § 292.304(d)(2).

208. *Id.* § 292.304(b)(5), (d).

209. Small Power Production and Cogeneration Facilities: Regulations Implementing Section 210 of the Public Utilities Regulatory Policies Act of 1978, 45 Fed. Reg. 12,214; 12,224 (1980) (to be codified at 18 C.F.R. § 292.304(b)(5), (d)) [hereinafter Regulations Implementing § 210]; *see also* Armco Advanced Materials Corp. v. Pennsylvania Pub. Util. Comm'n, 579 A.2d 1337, 1347 (Pa. Commw. 1990).

210. 18 C.F.R. § 292.304(a) (1993). "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the QFs, such utility would generate itself or purchase from another source. 18 C.F.R. § 101(6) (1993). Taken literally, FERC's rules seem inconsistent. *Compare* 18 C.F.R. § 292.304(b)(2) (1993) (FERC stating that "a rate for purchases satisfies the requirements . . . of this section if the rate equals the avoided costs . . . .") *with* 18 C.F.R. § 292.304(b)(5) (1993) (FERC stating that "[i]n the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery."). *See also* 18 C.F.R. § 292.304(a)(2) (1993) (FERC stating, "[n]othing in this subpart requires any electric utility to pay more than the avoided costs for purchases").

A reconciliation of this language begins with the fact that "avoided costs" are not constant and could in fact vary by the time of day since a utility's power from different generating sources varies as its load needs change. Also, since FERC contemplated contracts with rates based on estimated avoided costs, FERC also contemplated that over the life of a contract true avoided costs could vary above and below any estimate. FERC's view was that variations above and below the true avoided costs would balance out eventually and that was more important to ensure that a qualifying facility contracting with an electric utility not be deprived of the benefits of its commitment as a result of such varying circumstances. *See* Regulations Implementing § 210, *supra* note 209. For a general article on the topic of avoided costs, see Steven R. Miles, *Full-Avoided Cost Pricing Under the Public Utility Regulatory Policies Act: "Just and Reasonable" to Electric Consumers?*, 69 CORNELL L. REV. 1267 (1984).

avoided costs were likely to be higher or lower. FERC's view was that, as long as the total payment during the contract term did not exceed the estimated avoided costs, the contract would comply with FERC's rules.[211] FERC expressed the view that the bargain struck should be preserved whether the QF was paid at an avoided cost higher or lower than the actual cost ultimately experienced.[212] Although the QF benefitted in the former case, the utility benefitted in the latter. In both cases both parties benefitted by the certainty of a bargain.[213]

Finally, FERC directed each state regulatory authority, the state agency exercising rate-of-return regulation over the privately-owned electric utilities, to implement the FERC rules concerning the purchase of electricity from QFs by privately-owned electric utilities. FERC did not specify how this was to be done. It merely stated that, "implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities . . . or any other action."[214]

The layered and delegation from Congress to FERC to the various state regulatory authorities resulted in a lack of clarity about the appropriate forum to resolve disputes regarding the various provisions of PURPA. For example, PURPA provides that those adversely affected may seek state court review of state regulatory authority actions regarding relations between QFs and utilities.[215] Another PURPA provision gives FERC enforcement authority against the states, enforcement authority which may be initiated by an electric utility or QF.[216] Yet another provision provides judicial review before a federal district court if FERC does not begin an

211. Regulations Implementing § 210, *supra* note 209.
212. *Id.*
213. *Id.*
214. 18 C.F.R. § 292.401(a) (1993). For early implementation by the states, see Reinier H.J.H. Lock & Jack C. Van Kuiken, *Cogeneration and Small Power Production: State Implementation of Section 210 of PURPA*, 3 SOLAR L. REP. 659 (1981).
215. 16 U.S.C. § 824a-3(g)(1) (1988). "Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority . . . for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same requirements, as judicial review may be obtained under section 123 [16 U.S.C. § 2633] in the case of a proceeding to which section 123 . . . applies." *Id.* (citation omitted). 16 U.S.C. § 2633(C)(1) (1988) states, "[a]ny person . . . may bring an action to enforce the requirements of this title in the appropriate State court . . . ."
216. 16 U.S.C. § 824a-3(h)(2)(A) (1988).

enforcement action within sixty days of receiving a petition requesting such action.[217] The legislative history of the judicial review provisions of PURPA states, "the jurisdiction of the Federal courts is limited by this section; review and enforcement is primarily in the state courts. Federal court review can occur only in limited instances described in this section . . . ."[218]

Recognizing the confusion attendant to these provisions, FERC issued an Enforcement Policy Statement[219] in an attempt to set forth its position with respect to the ambiguity in federal and state enforcement authority. FERC first outlined the ways in which states could implement PURPA, stating:

> Under section 210(f) of PURPA, State regulatory authorities . . . are required to implement the Commission's [FERC's] rules . . . . The Commission has indicated that the obligation to implement section 210 rules is a continuing obligation. This requirement may be fulfilled either: 1) through the enactment of laws or regulations at the State level; 2) by application on a case-by-case basis by the State regulatory authority, or nonregulated utility, of the rules adopted by the Commission; or, 3) by any other action reasonably designed to implement the Commission's rules.[220]

Then FERC stated:

> The Commission perceives that its primary role in the statutory scheme of review and enforcement is to ensure that the State regulatory authorities and [un]regulated electric utilities implement regulations under section 210(f) which are consistent with the regulations established by the Commission under section 210(a) of PURPA. However, once the State regulatory authorities . . . have appropriately implemented the Commission's regulations, the Commission's role is limited regarding questions of the proper application of these rules on a case-by-case basis.[221]

This language has been interpreted to mean that state courts are the appropriate forum for resolution of most *individual* controversies[222]

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217. *Id.* § 824a-3(h)(2)(B).

218. H.R. REP. NO. 1750, 95th Cong., 2d Sess. 83-84 (1978), *reprinted in* 6 U.S.C.C.A.N. 7817-18 (1978).

219. Policy Statement, *supra* note 15:

> In this document, the Commission is defining the role it intends to assume in enforcing the provisions of section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) and defining the relationship of its enforcement authority to State judicial enforcement authority. The purpose of this document is to clarify our view of our appropriate place in an apparently ambiguous statutory enforcement scheme and to inform affected persons of the forums available if the PURPA requirements are not fulfilled. This document does not constitute a change in policy or a determination on the merits of any case.

Id. at 1.

220. *Id.* at 2.

221. *Id.* at 9.

222. *See* WILLIAM F. FOX, FEDERAL REGULATION OF ENERGY § 30.11, supp. at 158 (1983):

> FERC notes that all state regulatory authorities and utility companies have a statutory duty to comply with PURPA by promulgating regulations consistent with both PURPA itself and FERC's own regulations. However, once FERC has assured itself that states have proper regulations in place, its 'role is limited regarding proper application of those rules on a case-by-case basis.'

arising from the application of FERC's PURPA regulations.

FERC's attempt to consistently interpret the various judicial review provisions of PURPA led it to distinguish between its review and enforcement authority over the "implementation" of PURPA rules versus the state courts' review and enforcement authority over the "application" of PURPA rules. FERC's Commissioner Trabandt provided the most elucidation of what FERC intended in a searching inquiry about this aspect of FERC's enforcement policy statement. He stated:

> Even as to 'implementation' questions, we never pronounced our authority exclusive, nor did the Commission indicate that it would begin proceedings here if the aggrieved party has taken the exact questions to the state courts. I read our policy statement as providing complainants the choice of coming here or going to the states. However, if parties came before our agency with questions of 'implementation' — the broad, generic challenge to state commission action — we would entertain the complaint. On the other hand, the Enforcement Policy Statement calls for those challenging state actions, *as applied*, to go to state court.[223]

> (citation omitted) Thus, the dispute resolution forum for most individual controversies is the state court, not FERC.

Id.; *see also* Policy Statement, *supra* note 15.

223. Industrial Cogenerators v. Florida Pub. Serv. Comm'n, 43 F.E.R.C. ¶ 61,545, at 49 (1988) (Trabandt, Comm'r, dissenting) (emphasis added). Commissioner Trabandt's dissenting comment seems to be firmly grounded on the direct statements of the Policy Statement, *supra* note 15:

> As we have already noted, the Commission believes that its jurisdiction to review and enforce the section 210(f) implementation requirement (i.e., the requirement that State regulatory authorities and nonregulated electric utilities promulgate rules consistent with the requirements established by this Commission under section 210(a) of PURPA) is not exclusive. In fact, we would anticipate that generally proceedings would be initiated at the State level.

Policy Statement, *supra* note 15, at 6. And later:

> The Commission notes that its enforcement jurisdiction in this regard is not exclusive. Section 210(g)(1) provides that any person may seek judicial review of any proceeding conducted by a State regulatory authority or nonregulated electric utility without petitioning this Commission. This provision appears to include procedural as well as substantive judicial review. Moreover, procedural challenges may be raised independently under applicable provisions of State law.

Id. at 8.

These views are reflected in a more recent FERC decision. *See* Metropolitan Dade County, Fla. v. Energy Sys. Div. of Thermo Electron Corp., Docket No. QF83-248-002. This dispute came to FERC after a cogeneration facility filed suit in state court against its main purchaser, Dade County, for breach of contract. Dade County claimed the purchase contracts were void because the cogenerator did not qualify as a QF. The parties agreed to seek a ruling from FERC regarding the cogenerator's QF status. FERC decided the QF status of Thermo Electron's facility but declined to assert (or deny) that it had exclusive or even primary jurisdiction over the determination. At the same time, FERC declined to declare that state courts have the authority to determine a facility's QF status thus creating a presumption in favor of primary jurisdiction. Finally, FERC

The few occasions that FERC or the courts have had to pass upon this question have affirmed the view that these disputes belong in a state court.[224] In *Roche Procducts, Inc.*,[225] FERC stated, "matters of application of [a utility's rules] . . . are properly brought before State judicial forums."[226] In *Snow Mountain Pine Co. v. CP National Corp.*[227] it held, "[a]s the commission has previously noted, complaints regarding an alleged refusal to purchase power from a qualifying facility and the rates for such purchases are matters properly brought in a State forum."[228] In holding that it lacked subject matter jurisdiction (and therefore never reaching a state law breach of contract claim), a federal district court held, in relevant part, that any subsequent claim regarding a dispute over implementation "in its dealings with a particular qualifying facility must be brought in state court . . . ."[229] The court of appeals affirmed, stating that, "[t]he district court held that it lacked subject matter jurisdiction over Greensboro's 'as applied' claim, and we find its reasoning persuasive."[230] Thus, it is clear that "as applied" disputes, which would encompass contract disputes, are being channeled to the state courts for resolution, away from FERC and the federal district courts.

In summary, PURPA channels QF-utility disputes to the states but it is not entirely clear what state forum is intended. One possibility, the one with stronger referential support, could be that once "as applied" disputes are channeled into the states' jurisdiction, they are

left all contract questions to the state court litigation.

224. In a recent action before the federal district court in the Northern District of California, the CPUC advanced a similar argument seeking dismissal of a complaint on the basis, among other things, that the court lacked subject matter jurisdiction because, "[u]nder the facts of this case, the only available private right of action for Plaintiffs is in state court." Memo on Subject Matter Jurisdiction, *supra* note 186, at 7. Earlier, in a Memorandum of Points and Authorities In Opposition To a Motion For a Temporary Restraining Order, the CPUC stated, "To be sure, this case rests on nothing more than a potential *contract dispute* between the plaintiffs [QFs] and utility companies." Memorandum of Points and Authorities of Defendant Public Utilities Commission in Opposition to a Motion for a Temporary Restraining Order at 1, Independent Energy Producers Assoc. v. California Pub. Util. Comm'n, 1992 WL 533058 (N.D. Cal. 1992) (No. C-91-2644-SAW) (emphasis added).

Although the district court did eventually rule that it had subject matter jurisdiction, it did not address the argument made by the CPUC since the court assumed jurisdiction on the basis that the plaintiffs' claim was based on the Supremacy Clause. Independent Energy Producers Assoc. v. California Pub. Util. Comm'n, 1992 WL 533058 at *5 (N.D. Cal. 1992) (No. C-91-2644-MHP) (memorandum and order).

225. Roche Prods., Inc., 29 F.E.R.C. ¶ 61,098 (1984).

226. *Id.* at 4.

227. Snow Mountain Pine Co. v. CP Nat'l Corp., 30 F.E.R.C. ¶ 61,293 (1985).

228. *Id.* at 6.

229. Greensboro Lumber Co. v. Georgia Power Co., 643 F.Supp. 1345, 1374 (N.D. Ga. 1986), *aff'd per curiam*, 844 F.2d 1538, 1542 (11th Cir. 1988).

230. Greensboro Lumber Co. v. Georgia Power Co., 844 F.2d 1538, 1542 (11th Cir. 1988).

then divided between the appropriate dispute resolution forums according to the law of the state. That is, under state law, those "as applied" disputes within the constitutional and statutory jurisdiction of the CPUC would go to the CPUC for resolution, and those "as applied" disputes within the constitutional and statutory jurisdiction of the courts would go to the courts. The resolution of contract disputes in California (and most states) would then proceed along the lines of the analysis in Section III.B, *supra*, which resulted in a reservation of contractual adjudicatory authority to the courts. Another reading, however, could be that "as applied" disputes, including contract disputes, are being channeled into the relevant "state regulatory authority," i.e., the CPUC, with the various references to "state court" or "state courts" referring to state judicial review of final CPUC decisions.[231] Although there is no supporting reference in the statute for this possibility, it is an interpretation that is not inconsistent and which would reconcile the occasional ambiguous reference to directing resolution of disputes to a "state judicial forum" or a "state forum." It is a possibility worth considering since approbation of contractual adjudication by an agency has been based, in part, on the "check" provided by judicial review of an agency adjudication.[232] This possibility, however, implicates and invites consideration of state constitutional principles.

231. The CPUC apparently finds authority to adjudicate contract disputes between QFs and utilities in the FERC mandate to implement PURPA:

> The CPUC's decision clearly complies with all of these regulations. Here, the CPUC has taken action in "resolv[ing] disputes between [QFs] and electric utilities arising under" purchase power contracts. In doing so, the CPUC has determined an appropriate avoided cost rate taking into account "the terms of any contract," and "sanctions for noncompliance" with FERC-mandated efficiency standards. The CPUC has not decertified a QF which fails to meet FERC-efficiency standards; instead, it has *adopted an alternate avoided cost where there is a material breach of the contract* by the QF's failure to maintain these standards.

Memorandum of Points and Authorities of Defendant Public Utilities Commission in Opposition to Motion for a Temporary Restraining Order at 9, Independent Energy Producers Assoc. v. California Pub. Util. Comm'n, 1992 WL 533058 (N.D. Cal. 1992) (No. C-91-2644-SAW) (emphasis added). Here the CPUC has strung together language from 18 C.F.R. Sec. 292.401(a) and 18 C.F.R. Sec. 292.304(e)(iii) which delegates quasi-legislative authority to the CPUC and then misapplies it in reaching a legal conclusion dependent on adjudicative facts (a material breach), which presumably should be the result of an adjudicatory proceeding, and then retrospectively modifies existing contracts (adoption of the alternate avoided cost).

Except for this misconstruction of FERC's regulations, there is no other language that can support a claim that FERC has delegated adjudicatory powers over *contract* matters to the CPUC.

232. *See* Fallon, *supra* note 3.

D. *State Constitutional Limitations*

The relationship of Article III courts and non-Article III tribunals (FERC, for example) at the federal level is paralleled at the state level by the relationship between state courts and state regulatory authorities (such as public utility commissions). The comment from the *Afton*[233] court in Section IV, *infra*, clearly shows that concern over reserving the essential attributes of judicial power is held at the state as well as the federal level.[234]

Three years after *Schor*,[235] the California Supreme Court revisited (after fifty years) the issue of agency adjudications in the case of *McHugh v. Santa Monica Rent Control Board*.[236] The court, in its view, brought the law up to date with that of its sister state courts and the federal courts.[237] While the court did change California constitutional law so that it was consistent with the development of state and federal constitutional law in this area, it did not go beyond these contemporary developments. Therefore, if *McHugh* is applied to the CPUC's adjudication of QF-utility contracts, it should not be surprising that the CPUC is likely to be found acting contrary to California constitutional law.

In *McHugh*, two tenants filed an administrative complaint against their landlord (McHugh) alleging that they had been charged excess

233. Afton Energy Inc. v. Idaho Power Co., 729 P.2d 400, 403 (Idaho 1986); *see infra* text accompanying notes 267-70.

234. Although the *Afton* court was dealing with a QF contract, which is directly on point to the concern of this article, it proposes a more general rule that a public utilities commission does not have jurisdiction over the adjudication of private contracts. This view has been affirmed in numerous states. General Cable Corp. v. Citizens Util. Co., 555 P.2d 350, 355 (Ariz. 1976) ("construction and interpretation to be given to legal rights under a contract resides solely within the courts and not with the Corporation Commission"); Wilshire Constr. Co. v. Union Elec. Co., 463 S.W.2d 903, 905 (Mo. 1971) (meaning of contracts a matter for courts); Ranft v. Columbia Gas of Ohio, 388 N.E.2d 759, 761 (Ohio 1978) (courts, not PUC, had power to determine legal rights and liabilities under affected contract); Benwood McMechen Water Co. v. City of Wheeling, 4 S.E.2d 300, 303 (W. Va. 1939) (Commission has authority to pass on whether utility may enter into contract, but once contract is signed, its interpretation must be determined by courts).

235. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

236. McHugh v. Santa Monica Rent Control Bd., 49 Cal. 3d 348, 777 P.2d 91, 216 Cal. Rptr. 318 (1989).

237. The *McHugh* court states:

> Most important, as we explain below, the intervening five decades of case law show that unquestioning and rigid adherence to *Jersey Maid's* holding would place us out of step with every sister-state court of this country that has considered administrative awards of "restitutive" damages. Given this fact, we decline to treat *Jersey Maid* with the same deference we would normally accord an earlier opinion under the doctrine of stare decisis.

McHugh, 49 Cal. 3d at 358, 777 P.2d at 97, 216 Cal. Rptr. at 324 (construing Jersey Maid Milk Products Co. v. Brock, 13 Cal. 2d 620, 91 P.2d 577 (1939)).

rent in violation of a city rent control ordinance[238] to be administered by the Santa Monica Rent Control Board.[239] The ordinance regulated the maximum allowable rents and authorized adjustments in maximum rents through both general and individual proceedings.[240] In addition to providing misdemeanor penalties, the ordinance permitted a court action for damages.[241] The ordinance further provided for an alternative administrative remedy. In lieu of filing a civil action, the Rent Control Board was to establish, by rule and regulation, a hearing procedure to determine violations. After such a determination, the tenant would be authorized to deduct his damages, the excess rents from future rent payments.[242] In this case, the Board held that the tenants had been overcharged and awarded restitution of the excess rents paid.[243] The California Supreme Court was to decide the constitutionality of the provision for administrative adjudication of "excess rents."[244]

In an exhaustive opinion, the court reviewed the laws of nine states which had constitutional provisions substantially identical to Article VI, Section 1 of the California Constitution,[245] as well as federal decisions on the subject, discussed in Section IV.A, *infra*.[246] The court held that an administrative agency may hold hearings, determine facts, apply law to facts, and order relief (including certain types of monetary relief) as long as such activities are authorized by statute or legislation and are reasonably necessary to effectuate the administrative agency's primary, legitimate regulatory purposes.[247]

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238. *Id.* at 354, 777 P.2d at 94, 216 Cal. Rptr. at 321.
239. *Id.* at 353, 777 P.2d at 93, 216 Cal. Rptr. at 320.
240. *Id.*
241. *Id.*
242. *Id.* at 354, 777 P.2d at 93, 216 Cal. Rptr. at 320.
243. *Id.* at 354, 777 P.2d at 94, 216 Cal. Rptr. at 321.
244. *Id.* at 359, 777 P.2d at 97, 216 Cal. Rptr. at 324.
245. "The judicial power of this State is vested in the Supreme Court, courts of appeal, superior courts, municipal courts, and justice courts . . . ." *Id.* at 355, 777 P.2d at 94, 216 Cal. Rptr. at 321.
246. "Preliminarily, we note that some United States Supreme Court cases address, in the context of Article III of the federal Constitution, issues similar to those posed here." *Id.* at 364 n.16, 777 P.2d at 101 n.16, 216 Cal. Rptr. at 328 n.16. "Our constitutional provision confining 'judicial powers' to the courts . . . has counterparts in most other state constitutions, as well as the federal constitution." *Id.* at 365, 777 P.2d at 101-02, 216 Cal. Rptr. at 328-29.
247. One qualification of the court's holding, that the activities be authorized by statute or legislation, was necessary in *McHugh* because the Santa Monica Rent Control Board was a non-constitutional agency. While a constitutional administrative agency may have some constitutionally conferred or inherent judicial powers, a non-constitutional agency must have such judicial powers specifically conferred by statute or legislation. After establishing that the Santa Monica Rent Control Board's action was

Because the ordinance met this standard, the Board could adjudicate tenants' claims for excess rent and order restitution of excess

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authorized by ordinance, the issue for the court was the extent to which the exercise of such judicial power would be constitutionally permitted. The challenge for the court was how to reconcile judicial actions of an agency with the constitutional language of Section 1 of Article VI ("The judicial power of the state is vested in the Supreme Court, courts of appeal, superior courts, municipal courts and justice courts.") and Section 3 of Article III ("The powers of state government are legislative, executive and judicial. Persons charged with the exercise of one power may not exercise either of the others except as permitted by this Constitution."). See Comment, *Louisiana's Constitutional Agencies: Plenary Powers or "Constitutional Illusions of Being a Fourth Branch of Government,"* 51 LA. L. REV. 875 (1991), for an exploration of similar tensions in that state's constitutional structure. The *McHugh* court concluded:

> Our constitutional provision confining "judicial powers" to the courts has counterparts in most other state constitutions, as well as the federal Constitution. Modern courts, however, have not rigidly construed these provisions. Instead, a more tolerant approach to the delegation of judicial powers has emerged out of a perceived necessity to accommodate administrative adjudication of certain disputes and thereby cope with increasing demands on our traditional judicial system.

McHugh, 49 Cal. 3d at 365-66, 777 P.2d at 101-02, 216 Cal. Rptr. at 328-29 (citations omitted). With respect to the other qualification, that the exercise of judicial power by an agency be reasonably necessary to effectuate the administrative agency's primary legitimate regulatory purposes, the court in *McHugh* did not have much difficulty in finding that the agency's primary, legitimate regulatory purpose was setting and regulating maximum rents in the local housing market and that the agency's incidental remedial authority was circumscribed [the Board only adjudicated tenants' complaints of excess rents] and extended only so far as necessary to set and regulate rents. The court then held that the Board may adjudicate tenant complaints of excess rents and order restitution when necessary.

McHugh is significant for four reasons. First, it gave a new broadened meaning to the "except as permitted by this Constitution" language of Article III, Section 3 of the California Constitution. Now statutorily conferred judicial power could be constitutionally exercised by an administrative agency. Second, in doing so *McHugh* blurred the distinction between a constitutional agency and a non-constitutional agency. While the distinction is, for the moment, still important with respect to the scope of judicial review, *Strumsky v. San Diego County Retirement Assn.*, 11 Cal. 3d 28, 112 Cal. Rptr. 805, 520 P.2d 29 (1974), this distinction, which had formerly been determinative (*See Strumsky*, 11 Cal. 3d 28, 42, "[A]rticle VI disposes of *all* judicial power not expressly disposed of elsewhere in the Constitution. . . ."), is now meaningless with respect to the question of whether the exercise of judicial power by an agency is legitimate. Third, having diminished the significance of the distinction, the court necessarily shifted from a structural analysis to a functional one. That is, the analysis was no longer framed by the structural question of ascertaining the source of judicial power and its concomitant legitimacy. It was now framed by an inquiry of the functional balancing of the extent to which the judicial power may be exercised consistent with the California Constitution. (See text of notes 304-60 for the similar shift at the federal level.) Finally, *McHugh* was of significance because it specifically set forth the functional analytic approach to be followed in future cases. The court stated in *Walnut Creek Manor v. Fair Employment and Housing Comm.*, 54 Cal. 3d 245, 814 P.2d 704, 284 Cal. Rptr. 718 (1991):

> Although in *McHugh* we reserved the question now before us — i.e., whether an administrative agency's award of general compensatory damages violates the judicial powers clause (49 Cal.3d at p. 375, fn. 38), we clearly set out the approach for resolving the issue. In applying the first or substantive prong of the standard, i.e., the "reasonable necessity/legitimate regulatory purpose" requirements, we first inquire whether the award is authorized by legislation, and is "reasonably necessary to accomplish the administrative agency's regulatory purposes." (49 Cal.3d at p. 374) Next, we must "closely scrutinize the agency's

amounts.[248] However, the court held that the Rent Control Board could not authorize tenants to withhold their rents as a means of recovering alleged overpayments.[249]

The court held that the "principle of check," a procedural limitation on the remedial powers of agencies, would be violated.[250] It held that the Board, in practical effect, issued a self-enforceable judgment, which thereby violated the judicial powers clause. The court was concerned that under the Board's procedures,

> the Board possesses the ability to make an order that, although not "final" or "self-enforcing" in the typical sense of those terms, is in fact immediately enforceable in a real sense at the discretion of a private party. By its own regulations, the Board's decision becomes final "at the time of Board action," i.e., immediately after the Board renders its decision. Thereafter a tenant may withhold rent up to the amount specified by the Board. In this fashion the Board's order is given immediate practical effect: before the landlord has even the opportunity to obtain judicial review by petition for writ of mandate and a stay of the Board's order, the tenant is allowed to withhold rent money otherwise due. In addition the Board's order is also thereby given legal effect: the order, pursuant to the [ordinance], is an affirmative defense to an unlawful detainer action based on the tenant's nonpayment of rent.[251]

We can now consider application of *McHugh* and *Walnut Creek Manor* to the CPUC, a constitutional agency, in a recent de facto contractual adjudication. On May 8, 1991, the CPUC issued Decision 91-05-007[252] in response to applications by the three major electric utilities for approval of programs to monitor the efficiency of QFs. Among other things, the CPUC ordered the utilities to require QFs to submit efficiency data and to use it to determine whether the

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> asserted regulatory purposes in order to ascertain whether the challenged remedial power is merely incidental to a proper, primary regulatory purpose, or whether it is in reality an attempt to transfer determination of traditional *common law claims* from the courts to a specialized agency whose primary purpose is the processing of such claims."

Walnut Creek Manor, 54 Cal. 3d at 256, 814 P.2d at 709, 284 Cal. Rptr. at 723 (emphasis added). As applied to *Walnut Creek Manor* the court held that statutory authorization to award "actual damages" was valid insofar as it authorizes the commission to award damages amounting to equitable restitution and is invalid under the judicial powers clause insofar as it authorizes the award of other compensatory damages. The court was concerned that to permit the award of general compensatory damages would be to permit the agency to award a remedy "in the manner of a traditional private tort action in a court of law." *Walnut Creek Manor*, 54 Cal. 3d at 264, 814 P.2d at 715, 284 Cal. Rptr. at 729. (See text of notes 304-60 for a more detailed analysis of the impropriety of administrative adjudication of common law claims.)

248. *McHugh*, 49 Cal. 3d at 375, 777 P.2d at 109, 261 Cal. Rptr. at 336.
249. *Id.* at 377, 777 P.2d at 110, 261 Cal. Rptr. at 337.
250. *Id.* at 375, 777 P.2d at 109, 261 Cal. Rptr. at 336.
251. *Id.* at 376, 777 P.2d at 109, 261 Cal. Rptr. at 336 (citations omitted).
252. *In re* Southern Cal. Gas, Dec. No. 91-05-007, 123 P.U.R.4th 13 (1991).

QF was meeting FERC efficiency standards.[253] The CPUC pronounced that failure by a QF to maintain FERC's efficiency standards would be a material breach of the QF-utility contract[254] and it authorized the utilities to suspend a QF's contract benefits. Such a QF could be paid no more than eighty percent of the avoided costs set forth in the contract.[255] Moreover, utilities were ordered to recapture "overpayments" to QFs which are later determined to have been out of compliance.[256] The utilities were further authorized to disconnect non-complying QFs.[257]

Through this Order, the CPUC (1) effectively broadly adjudicated what should be an individual factual determination, that a QF's failure to maintain its "warrant" constituted a material breach,[258] (2) ordered modifications to a QF's contract, (3) authorized a total

253. *Id.* at 27.

254. *Id.* at 26. Although the CPUC argued that it was acting under delegated authority from FERC to resolve contract disputes, shortly thereafter at least one FERC Commissioner's view, as well as the affected California utility's view, was that the consequences of the loss of QF status should be an adjudicatory matter before the state courts. *See* Kramer Junction Co., 62 F.E.R.C. ¶ 61,309 (1993) (Terzic, Comm'r, concurring). Ironically, the FERC decision on *Kramer Junction* excuses a planned, i.e., willful, noncompliance with PURPA's regulations and the CPUC decision on loss of QF status visits with considerable retribution, an unavoidable or negligent non-compliance with the same regulations. The appropriate actions would have been for FERC to deny the waiver request and for the CPUC never to have issued its order. In general, if the utility has reason to suspect that the QF is not performing in accordance with the contract, then the utility should seek assurances. If reasonable assurances are not given or, despite the assurances, the contracted performance is not rendered, then the utility may cease its own performance and seek appropriate damages. A complaint by either party regarding contractual performance would properly lie before the state court of appropriate jurisdiction.

255. *Southern Cal. Gas*, 123 P.U.R.4th at 26-27.

256. *Id.*

257. *Id.*

258. The QF-utility standard offer contract contains a provision in which the QF *warrants* that "qualifying facility" status shall be maintained during the performance of the contract. *See, e.g., id.* at 13. Qualifying facility status can be granted by FERC on a pro forma basis. 18 C.F.R. § 292.207(b) (1993). Status also can be obtained by self-certification. 18 C.F.R. § 292.207(a)(2) (1993). For cogenerators, minimum efficiency standards are set in order to obtain FERC certification. Alternatively, a QF can self-certify that it is meeting such standards. It is not clear what a "warrant" was intended to be in the QF-utility contracts. It is unlikely that it can be considered a representation because a representation usually precedes and induces the contract. QF contracts usually warrant the QF status from performance on. A QF "warrant" could therefore be a warranty but in that case a breach of warranty does not justify forfeiture of the contract (i.e., is not material), and the contract remains binding while damages are recoverable for the breach, but must be proven. It is possible that the QF "warrant" could be considered a condition, but under contract law failure to meet a condition may or may not be a material breach justifying forfeiture of the contract. On whether the failure to meet a condition is a material breach justifying forfeiture, Judge Cardozo wrote:

> The question is one of degree, to be answered, if there is doubt, by the triers of the facts, and, if the inferences are certain, by the judges of the law. We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfillment is to be implied by law as a condition.

Jacob & Youngs v. Kent, 129 N.E. 889, 891 (N.Y. 1921) (citations omitted).

breach of the utility's contractual duties (which would not necessarily be legally discharged by a failure to meet the "warrant" by a QF), and (4) authorized a withholding of QF payments in violation of the "principle of check" as set forth by *McHugh.*

Perhaps it could be argued that *McHugh* is not applicable since the CPUC sits as a federal tribunal under delegated federal authority. If so, the CPUC still could choose to be informed by California law.[259] If, however, it rejects that possibility, the applicable law then would be federal decisional law. *Schor* would then apply and the result would be the same. While *Schor* approved of limited delegated adjudicatory authority to an agency, it did so with some qualifications. A major qualification was that "CFTC orders . . . are enforceable only by order of the district court."[260] The CPUC not only delegated adjudicatory authority to a private party, the utilities, but its order directed immediate execution of the decision by the utilities prior to any judicial review.

If, however, the availability of judicial review of the CPUC decision, rather than the unavailability of judicial review prior to execution of the utilities' individual determinations, were to somehow satisfy *McHugh's* "principle of check," it is still likely that the CPUC's decision would be an unconstitutional remedial action. The court's holding in *Walnut Creek Manor*[261] made very clear that there are "substantive" as well as "procedural" limitations on the exercise of judicial power by an administrative agency. The court stated:

> In effect, the commission would have us find that satisfaction of the procedural prong of the *McHugh* standard — the "principle of check" [citation omitted] — is sufficient to meet a judicial powers challenge to an agency's

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259. A federal court applying federal common law may look to state law for guidance:

> The fact that an area has been recognized as requiring the application of federal common law does not necessarily mean that state law will be ignored. Federal courts in their discretion may decide that on a given matter state law is the most appropriate choice, and adopt it as the federal rule of decision. The decision to use state law may be based on numerous factors: (1) congressional intent as expressed in a statute or legislative history; (2) the existence of substantial state interest that would be served by the incorporation of local law; (3) the fact that federal and state law are closely interwoven; (4) the furtherance of equity; or (5) as a matter of convenience when federal law is silent on a particular issue.

JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE 231-32 (2d ed. 1993).

260. Commodities Futures Trading Comm'n v. Schor, 478 U.S. 833, 853 (1986).

261. See *supra* note 247 for a fuller discussion of *Walnut Creek Manor.*

administrative adjudications . . . . In *McHugh*, moreover, we expressly rejected the proposition that "an administrative agency may exercise all manner of 'judicial-like' power on the simple condition that judicial review of the administrative decision remains available." (49 Cal.3d at p. 364). Although we recognized that sister states' decisions have occasionally accorded little consideration to the "substantive limitations" principle discussed above (*id.* at p. 371), we adhered to the guiding principles of substantive as well as procedural limitations on the remedial powers of administrative agencies (*id.* at p. 374).[262]

Consideration of such "substantive" limitations led the court in *Walnut Creek Manor* to hold that an award by an administrative agency of damages beyond equitable restitution is an unconstitutional exercise of judicial power.[263] On its face, the CPUC's decision resolved a contractual dispute between QFs and utilities which awarded the utilities a remedy beyond equitable restitution.

IV. QF CONTRACTUAL ADJUDICATION IN THE FEDERAL SCHEME

. . . differences regarding promise-making and promise-breaking should only be settled by special judicial tribunals. This was a very strong and revered tradition.

There has not been uniformity among the states in their implementation of PURPA with respect to QF contractual adjudications. For example, there is little question that the CPUC has adjudicated QF-utility contract disputes, notwithstanding the characterizations of these contract disputes as "complaints," "petitions," or "applications."[264] Amid the uncertainty of the legal basis for PURPA implementation and enforcement, with petroleum supply interruptions in 1979 and 1981 as strong reminders of the policy basis for PURPA and with a strong policy push by the California Legislature, the CPUC undertook vigorous efforts to implement Section 210 through its standard offer contracts.[265] As a consequence of an expansive interpretation of its PURPA implementation responsibilities, the CPUC gradually extended its review and enforcement authority over these contracts. It was drawn more and more into adjudicating the private contracts authorized by Section 210—the contracts between qualifying facilities and electric utilities. Contract matters adjudicated by the CPUC included acceptance, mutual assent, breach of contract, contract interpretation, contract modifications, good faith, detrimental reliance, force majeure, consent to assignment, and promissory estoppel.[266]

262. Walnut Creek Manor v. Fair Employment and Housing Comm'n, 54 Cal. 3d 245, 265, 814 P.2d 704, 715-16, 284 Cal. Rptr. 718, 730 (1991).

263. *Id.*

264. *See supra* notes 81-92 and accompanying text.

265. *See generally* MILLER, *supra* note 101.

266. The CPUC took an early and aggressive role in the development of QF power. *See* ALVIN ALM & KATHRYN STEIN, ELECTRIC POWER STRATEGIC ISSUES 237-64

Other state regulatory authorities faced similar problems but did not share the CPUC's penchant for contractual adjudication. In *Afton Energy, Inc. v. Idaho Power*,[267] for example, the Idaho Supreme Court affirmed a decision of the Public Utilities Commission of that state to decline to interpret a power purchase contract between a utility and a QF that was entered into pursuant to PURPA. The *Afton* court stated:

> Generally, construction and enforcement of contract rights is a matter which lies in the jurisdiction of the courts and not in the Public Utilities Commission. This is true notwithstanding that the parties are public utilities or that the subject matter of the contract coincides generally with the expertise of the commission. If the matter is a contractual dispute, it should be heard by the courts.[268]

The Pennsylvania Commission also concluded that it had no authority to revisit executed QF contracts.[269] However, the Oklahoma

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(James Plummer et al. eds., 1983). Between 1980 and 1989, FERC filings for qualifying facility status numbered approximately 4400. California had the largest number (1520), followed by New York (371), New Jersey (234), Oklahoma (203), Pennsylvania (196), Texas (183), and Idaho. See FERREY, *supra* note 17, at 3-64, tbl. 3.6. Therefore, it is not surprising that, with the combination of the greatest number of QFs and a public utility commission accustomed to considerable intervention in the QF-electric utility interface, situations ripe for agency contractual adjudication would arise most often.

Typical of these contractual adjudications are: Sayles Hydro Assocs. v. Pacific Gas & Elec. Co., 38 C.P.U.C.2d 519 (1990) (contractual issue was interpretation of force majeure clause); Colmac Energy v. Southern Cal. Edison, 31 C.P.U.C.2d 549 (1990) (contractual issues raised included breach, promissory estoppel, good faith and fair dealing, reliance, and contract modification); Union Oil v. Southern Cal. Edison, 31 C.P.U.C.2d 339 (1989) (contractual issues raised included consent to assignment, mutual assent, unjust enrichment, restitution, promissory estoppel, express contract, implied-in-fact contract, implied-in-law contract, and contract modification); Integrated Energy Dev. v. Southern Cal. Edison, 25 C.P.U.C.2d 463 (1987) (contractual issue was mistake); Trigen v. Southern Cal. Edison, Dec. No. 87-09-080, 1987 Cal. PUC LEXIS 252 (1987) (contractual issue was method of acceptance); and Kingsburg v. Pacific Gas & Elec. Co., 25 C.P.U.C.2d 421 (1987) (contractual issue was delivery of acceptance).

Other states also had state regulatory authorities adjudicate contract claims: Biosyn v. Northern States Power, 1989 Minn. PUC LEXIS 107 (1989) (contract issues were repudiation, nonperformance, and bad faith); Bethlehem Steel Corp., Case No. 29006, 1985 N.Y. PUC LEXIS 532 (1985) (contract issues were interpretation and modification). *See also* Petitions for Clarification of Declaratory Ruling and Modification of Contract, in order of appearance: 1985 N.Y. PUC LEXIS 108 (1985); 1985 N.Y. PUC LEXIS 91 (1985); 1986 N.Y. PUC LEXIS 175 (1986); 1986 N.Y. PUC LEXIS 128 (1986).

267. 729 P.2d 400 (Idaho 1986).

268. *Id.* at 403 (quoting Lemhi Tel. Co. v. Mountain States Tel. & Tel. Co., 571 P.2d 753, 757 (Idaho 1977)).

269. Petition of Pennsylvania Elec. Co. Requesting Approval of Rate Recovery Under the Energy Cost Rate, For the Costs Proposed to be Paid Under an Agreement with Scrubgrass Power Corporation, 66 Pa. P.U.C. 151 (1988) ("[I]n our view federal law would act to prohibit us from reconsidering a prior approval of rate recovery of costs based upon projections that were reasonable at the time they were made."). See also FERRY, *supra* note 17, at 7-38, wherein he states that Texas and Michigan, by statute,

Commission, although lacking express authority, nevertheless adopted a rule, applied prospectively, that required every contract entered into by a utility to include a term that would enable the contract to be modified from time to time according to the Commission's decisions.[270]

FERC moved more slowly,[271] but the prospect of QF contract adjudication began to present itself there as well. In *Orange & Rockland Utilities*, FERC asserted preemption of state authority to establish power purchase rates in excess of avoided cost.[272] FERC, moreover, indicated that it might revisit and reallocate costs imposed by pre-existing QF contracts in states that imposed rates in excess of avoided cost.[273] Recently, a federal court referred such an issue to FERC, stating that the agency had primary jurisdiction.[274] In other words, FERC now faces the prospect of having to examine the extent to which it has authority to adjudicate and reform existing QF contracts.

Therefore, the differences among states in the adjudication of QF contracts and the possibilities of FERC involvement in QF contractual adjudications make pertinent the consideration of federal constitutional limits on agency contractual adjudication. Detailed analysis of such federal constitutional limits is necessary for three reasons. First, the federal constitutional limits would apply to FERC and possibly to state regulatory agencies if they are found to be acting as federalized tribunals in the implementation of PURPA.[275] Second, although FERC has purposely been slow in addressing these issues, FERC still retains powerful preemptive authority over the states and

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protect QF contracts against renegotiation.

270. Discussed in Applied Energy Servs. v. Oklahoma Corp. Comm'n, 31 F.E.R.C. ¶ 61,313 (1985). *See also* FERRY, *supra* note 17, at 7-37.

271. This has been due in large part to the fact that FERC has refused to interfere with the states' responsibility to establish avoided cost rates. *See* Applied Energy Servs., 31 F.E.R.C. ¶ 61,313 (1985).

272. Re: Orange & Rockland Utils., 43 F.E.R.C. ¶ 61,067 (1988). FERC stayed the enforcement of its administrative decision pending appeal. *Id.* ¶ 61,547. The Federal Court of Appeals dismissed an appeal of the FERC decision on the grounds of ripeness, pending conclusion of a FERC rulemaking. Occidental Chem. Corp. v. Federal Energy Regulatory Comm'n, 869 F.2d 127 (2d Cir. 1989).

273. *Occidental Chem. Corp.*, 869 F.2d at 128.

274. Connecticut Light & Power Co. v. South E. Conn. Regional Resources Recovery Auth., 822 F. Supp. 888 (D. Conn. 1993):

> After oral argument and a careful review . . . the court, *sua sponte*, raised with the parties the appropriateness of referring this matter to FERC, the governing administrative agency, under the doctrine of primary jurisdiction . . . . [T]he court believes that a referral of the preemption question to FERC is prudent.

Id. at 891.

275. This prospect raises federalism issues discussed later in this section of the article. *See infra* Section IV.B.

could regulate QF-utility contracts directly.[276] Third, since federal law has been elaborated recently and in quite a bit of detail, such analysis will in all likelihood substantially inform any state constitutional analysis, as it did in California in the *McHugh* case.[277]

As may be seen, the adjudication of QF contracts by a state or federal agency involves principles of federalism, federal preemption, and, as the state constitutional analysis indicated, separation of powers and checks and balances on those powers. These are difficult areas to plumb under any circumstances. Therefore, this section's interest in these areas will be narrow and specific — the significance of the often-expressed value of the common law of contracts in the discourse of these constitutional principles.

A. Embedded Efficiency as an Article III Limitation

Our modern legal system derives from the establishment of the centralized court system in thirteenth century England and the common law it developed.[278] Following American independence, "each of the American states in its original constitution adopted or 'received' the English common law as the basis for the law of that state."[279] Kessler and Gilmore inform us that state legislatures failed to play a major role in developing a body of private law, so the task fell to the state courts.[280] Considering the English origins and the timing of the elaboration of the common law in America, perhaps it should not be too surprising that "[t]here is, apparently, a mechanism at work in the common law that is similar to the work of the 'invisible hand' in markets."[281]

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276. Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742 (1982). The Supreme Court was in full agreement that there was more than ample basis for holding that Congress could fully preempt all state regulation in this area. It concluded that PURPA and the corresponding FERC regulations simply allowed the states to participate in a shared regulatory endeavor. *Id.*

277. McHugh v. Santa Monica Rent Control Bd., 49 Cal. 3d 348, 777 P.2d 91, 261 Cal. Rptr. 318 (1989). The California Supreme Court fully reconsidered California constitutional law regarding contractual adjudications by agencies and incorporated the most recent federal developments in the same area. *Id. See supra* Section III.D.

278. 1 WILLIAM S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 194-264 (1982).

279. CHARLES L. KNAPP & NATHAN M. CRYSTAL, PROBLEMS IN CONTRACT LAW 371 (3d ed. 1993).

280. FRIEDRICH KESSLER & GRANT GILMORE, CONTRACTS 13 (2d ed. 1970).

281. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 495 (1988). They continue:

> In one of social science's most famous metaphors, Adam Smith described the participants in a competitive market, who consciously pursue their private interests, as directed by an "invisible hand" to serve the public good. According

One of the early findings of applying economic analysis to the law was that, on the whole, the common law rules were efficient.[282] Early explanations for the efficiency of the common law included judicial affinity for efficiency and the character of common law litigation.[283] Subsequent quantitative analysis focused mainly on litigant behavior rather than judicial behavior.[284] In general, this body of work indicated that "selective litigation, like natural selection, can cause evolutionary change in the common law"[285] toward efficiency.[286] Most apropos to our inquiry in this section is one important conclusion of Priest's work which he expressed with great clarity: "this tendency toward efficiency is a characteristic of the common law process so that the content not only of the common law itself, but also of the legal interpretation of statutes or of the Constitution, is subject to forces pressing toward efficiency."[287] Later in the article he stated more precisely:

> To the extent that a statute or an interpretation of a statute imposes inefficiencies, it will be more likely to be overturned because of the greater likelihood of relitigation. Similarly, within the class of possible constructions of a given constitutional provision, those constructions with relatively more efficient allocative effects will tend over time to survive.[288]

However, in a comprehensive inquiry into the selective litigation hypothesis, Cooter and Kornhauser reached some sobering

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to Smith, government does not have to give directions to businesspeople competing in perfect markets; rather, government merely has to restrain itself from interfering and competitive markets will achieve efficiency on their own.

> A competitive market is a kind of social machine whose laws of operation allocate resources efficiently without anyone consciously striving for that goal.

Id. at 492-93.

282. *See infra* note 453.

283. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW Chs. 5 & 23 (1972).

284. Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 61 (1977) ("If decisions are made randomly, there will be a movement in the direction of efficient laws. The same model provides an explanation for using the courts to settle some disputes, rather than relying on out of court settlements."); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 66 (1977) ("My analysis provides a foundation for the more general theory that common law decision making facilitates over time the efficient allocation of resources."); John C. Goodman, *An Economic Theory of the Evolution of Common Law*, 7 J. LEGAL STUD. 393, 404 (1978) ("[W]e predict that common law will tend to be Pareto optimal."); A. KRONMAN & R. POSNER, THE ECONOMICS OF CONTRACT LAW 6 (1979) ("The efficient rules will eventually survive; the inefficient will be progressively ignored and eventually forgotten.").

285. COOTER & ULEN, *supra* note 281, at 494.

286. This evolution toward efficiency depends on the frequency of challenges to inefficient laws being greater than the frequency of challenges to efficient laws. See *id.* and the conditions and assumptions of the analyses set forth by the authors of the articles listed *supra* note 284.

287. *See* George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977). Although Priest was the only one who made this explicit, the same conclusion is implicit in the other works.

288. *Id.* at 73.

conclusions:

> We have borrowed a mathematical model of biological evolution to formalize the idea that the law can improve by an unguided evolutionary process. Our results suggest that differential litigation (more frequent litigation of bad laws) and differential investment (more spent on preparing the case against bad laws than on defending them) will have a moderate influence on the persistence of good rules in a legal process without judicial insight. The law will never reach the best state and remain there forever, but these evolutionary forces will improve the law relative to what it could be without them. For very simple processes, the legal system will tend towards a stable state in which good laws prevail a greater proportion of time than bad laws.[289]

The ultimate dependence of the selective litigation hypothesis on assumptions that (1) inefficient laws are litigated more often than efficient laws and (2) more resources are invested in preparing the case against inefficient laws has frustrated economists. They, as might be expected, seek certainty of conclusion,[290] notwithstanding the rather persuasive qualitative arguments made by the authors of these articles on behalf of these assumptions. Therefore, the theoretical economists have withdrawn from the field and have called upon econometricians to take up the challenge of verifying the assumptions.[291]

Perhaps as a result, attention has refocused on judicial behavior. Inquiries regarding the role of judicial insight focus on the role of precedent[292] and redistributive concerns.[293] That the common law can evolve towards efficiency due to judicial insight has been shown

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289. Robert Cooter & Lewis Kornhauser, *Can Litigation Improve the Law Without the Help of Judges?*, 9 J. LEGAL STUD. 139, 156-57 (1980).

290. *Id.* at 157. See also, in a surprising attenuation of the debate from one of the prime movers of the concept, William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235 (1979):

> Our analysis suggests that this literature has overstated the tendency of a common law system to produce efficient rules, although areas can be identified where such a tendency can indeed be predicted on economic grounds.
>
> Viewed as a contribution to the emergent literature on the positive economic theory of law, our finding that the public courts do not automatically generate efficient rules is disappointing, since it leaves unexplained the mechanism by which such rules emerge as they seem to have done in a number of the areas of Anglo-American judge-made law.

Id. at 284.

291. *See* Cooter & Kornhauser, *supra* note 289, at 157.

292. Robert Cooter et al., *Liability Rules, Limited Information, and the Role of Precedent*, 10 BELL J. ECON. 366 (1979):

> In Brown's model the courts permit variations in the level of care by litigants to influence the legal standard; by contrast we allow these variations to affect the information available to the court when reviewing the legal standard. The standard itself is not directly effected by the litigants, but the information

most clearly in one area of tort law.[294] Cooter and Kornhauser also proved, under the assumptions of their model, that "evolutionary forces are insufficient to cause the legal system to adopt and retain the best legal rule without the help of judges."[295] Despite their clarity and persuasive presentation of the selective litigation hypothesis, Cooter and Ulen doubt that selective litigation drives the law towards efficiency without the help of judges. They raise the possibility that "judges consciously prefer more efficient rules but that their own descriptions of what they are doing employ terms other than 'efficiency' " and hypothesize that "efficiency principles are embedded in the law under other names."[296]

In summary, accepting the assumptions of the selective litigation hypothesis, the common law will evolve toward efficient rules even under a legal process without judicial insight. At worst, for legal processes that are not simple, the evolutionary pull towards efficiency will be moderate, the legal rule reached will be unstable, and the legal rule will never be the most efficient. On the other hand, for simple legal processes, the evolutionary pull will result in a stable state in which efficient rules will prevail a greater portion of the time than inefficient rules. With judicial insight things only get better, even if judges are inarticulate about their preference for efficiency. Finally, judicial inarticulateness about the preference for efficiency might be the result of efficiency principles being embedded in the law under other names or concepts.[297]

The state of the law regarding the constitutionality of legislative delegations of judicial authority, which permit contractual adjudications by administrative agencies, can be explained by reference to the analysis above. First, as the analysis indicates and as clearly

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> which they provide is used to calculate it. This change in Brown's model produces a system which tends toward efficiency; the path of convergence is interpreted as a sequence of precedents. Incremental precedent leads to efficiency.

Id.

293. COOTER & ULEN, *supra* note 281, at 495-96 ("Unfortunately, the grip of the invisible hand on courts is far weaker than on markets . . . . The problem with viewing a court as a market is that redistributive gains are frequently more important than inefficiencies in channeling litigation.").

294. *See* Cooter et al., *supra* note 292.

295. *See* Cooter & Kornhauser, *supra* note 289, at 145.

296. COOTER & ULEN, *supra* note 281, at 497.

297. A similar explanation was offered by Humpty Dumpty in his exchange with Alice:

> "When *I* use a word," Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."
>
> "The question is," said Alice, "whether you *can* make words mean different things."
>
> "The question is," said Humpty Dumpty, "which is to be master —that's all."

LEWIS CARROLL, ALICE'S ADVENTURES IN WONDERLAND AND THROUGH THE LOOKING GLASS 197-98 (A. Wessels Co. 1900) (1985). It seems clear that Alice was an economist and Humpty Dumpty was a judge.

stated by Priest, the Supreme Court decision in *Schor* is the result of an evolutionary struggle for survival of a constitutional rule that would preserve allocative efficiency.[298] Second, the amorphousness, uncertainty, and unpredictability of the ad-hoc balancing test[299] developed in *Schor* to judge the constitutionality of legislative delegations of judicial authority might suggest that the rule of *Schor* is a rule (in the category of legal rules described by Cooter and Kornhauser) as unstable and not as efficient as other possible rules. Finally, the perspective provided by this analysis permits two prescriptive comments. First, the unstable nature of the rule of *Schor* presents an opportunity for corrective action. Second, the direction of the corrective action is suggested by the logical extension of the evolutionary metaphor. In other words, efficient rules survive best in hospitable habitats. With respect to the continued survival of efficient rules of contractual adjudication, courts are more hospitable habitats than are administrative agencies.[300]

The argument that can be marshalled to support the preceding conclusions is qualitative but plausible. First, with respect to whether there is an evolutionary pull toward efficiency, the analyses substantially agree that there is such an effect, given some basic assumptions. Second, with respect to those assumptions (that more inefficient rules are litigated more often and more resources are spent litigating inefficient rules), this is an empirical problem to which this article cannot provide an answer. The best that can be done is to refer the reader to the many persuasive arguments made by the authors who developed the arguments that evolutionary efficiency results from selective litigation.[301] We can only agree that the assumptions seem to be more than reasonable. An interesting point with respect to the legal rules that concern this article, contract rules, is the fact that contract disputes produce many more trials than do disputes in the other areas (property and tort) of substantive common law.[302] This might indicate that more resources are spent litigating inefficient contract rules and that inefficient contract rules are litigated more frequently.[303]

298. *See* Priest, *supra* note 284.
299. *See* Fallon, *supra* note 3.
300. This point is discussed in greater detail in Section V of this article.
301. *See supra* note 281.
302. COOTER & ULEN, *supra* note 281, at 478. They proffer that trials regarding contract disputes are ten times more frequent than trials regarding tort disputes and that the frequency of trials about property disputes is somewhere in between.
303. *See* COOTER & ULEN, *supra* note 281. They argue that this might indicate

Finally, with respect to whether the rule of *Schor* is in an unstable state and less efficient than other potential rules, we argue that the three major decisions of the Supreme Court in this area can be considered to involve non-simple legal processes, which Cooter and Kornhauser have indicated lead to unstable states, and the discourse in those decisions reflects the destabilizing tension of the trial and error of evolutionary processes. We also offer that Cooter and Ulen's hypothesis regarding judicial insight illuminates the significance of this discourse — that the judicial preference for efficiency is revealed in the irrepressibility of judicial concern about consequences to the common law of permitting agencies to adjudicate contracts. In other words, the judicial value for the common law inherent in Article III is more than "talismanic power." It is an unavoidable consequence of the efficiency embedded in the legal principle that common law claims should be heard by common law courts.

1. Separation of Powers, Adjudication, and the Common Law

The federal constitutional scheme vests legislative power in a Congress of the United States (Article I), the executive power in a President of the United States (Article II), and the judicial power in a Supreme Court (Article III). The United States Constitution states:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.[304]

The United States Supreme Court has interpreted this section as guaranteeing "the role of the independent judiciary within the constitutional scheme of tripartite government"[305] and protecting a litigant's "right to have claims decided before judges who are free from potential domination by other branches of government."[306]

A literal reading of Article III, that Congress is limited to creating only inferior courts which comply with Article III's requirements

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there is greater interest by a litigant in a redistributive rule rather than an efficiency rule. According to them, since the successful litigant would only capture a portion of the gains from a move to a more efficient rule, potential litigants are motivated less by potential efficiency gains than by potential redistributive gains. This possibility is explored in Section V of this article. The Section V analysis indicates that such an effect, to the extent that it occurs, would be much more pronounced, achievable, and more likely to occur before an administrative agency than before a court in the case of contractual adjudications.

304. U.S. CONST. art. III, § 1.

305. Thomas v. Union Carbide Agric. Prod. Co., 473 U.S. 568, 583 (1985).

306. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986) (quoting United States v. Will, 449 U.S. 200, 218 (1980)).

of judicial life tenure and undiminished salaries, cannot be sustained. Since 1828,[307] the Supreme Court has upheld Congressional delegation of adjudicatory powers to "legislative courts" and administrative agencies in accordance with Article I, section 8 of the United States Constitution and the Necessary and Proper Clause.[308] Additionally, the first Congress, "whose decisions often are viewed as a repository of insight into the historical intent underlying Article III, vested responsibilities in executive officers of the Treasury Department that might instead have been assigned to constitutional courts."[309] From the litigant's perspective, the court has never subscribed to the notion that an individual has an absolute right to an Article III tribunal for every claim.[310] However, the Court has now gone as far as to prescribe "practical attention to substance rather than doctrinaire reliance on formal categories" when applying Article III.[311]

The Court's recent and rapid journey from formal to functionalist interpretations of Article III, catalogued in the trilogy of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,[312] *Thomas v. Union Carbide Agricultural Products*,[313] and *Commodity Futures Trading Commission v. Schor*,[314] has resulted in what Fallon has described as "an ad hoc balancing test that is almost wholly open-ended and amorphous. The chief attraction of the Court's form of balancing seems to be that it avoids almost all of the most basic questions, or at least appears to do so. Uncertainty continues rife. Prediction is almost impossible."[315]

How then should one approach an analysis of whether agency adjudication of QF-utility contracts comports not only with explicit consitutional ideals but with embedded values which may include,

307. Chief Justice Marshall allowed Congress to create non-Article III tribunals called "legislative courts" to resolve disputes in the federal territories. American Ins. Co. v. Canter, 26 U.S. 511 (1828).

308. U.S. CONST. art. I, § 8, cl. 18.

309. Richard Fallon Jr., *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916, 919 (1988); *see also* Paul M. Bator, *The Constitution As Architecture: Legislative and Administrative Courts Under Article III*, 65 IND. L.J. 233, 235 (1990).

310. *See* Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 585 (1985); Crowell v. Benson, 285 U.S. 22, 53 (1932).

311. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 848 (1986) (quoting Thomas v. Union Carbide Agric. Prods., 473 U.S. 568, 587 (1985)); *see also* Crowell v. Benson, 285 U.S. 22, 53 (1932).

312. Northern Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).

313. Thomas v. Union Carbide Agric. Prods., 473 U.S. 568 (1985).

314. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

315. Fallon, *supra* note 3, at 917.

among others, the value of efficiency? Given the uncertainty mentioned above, it seems logical to approach the analysis with a hypothesis and then review the available data to confirm or reject the hypothesis. In this instance, the hypothesis shall be that the ideal that common law claims should be heard by common law courts is a value that has had great constancy in the Court's Article III jurisprudential journey. As has been suggested above, the constancy of that value may be both an evolutionary result as well as an embedded value for efficiency. We shall seek to find articulation for such a value in the constitutional discourse regarding the propriety of administrative agencies exercising Article III judicial powers. It is perhaps not coincidental, given our analysis above, that the three recent and major decisions in this area happen to involve agency adjudications of contracts. We shall then consider whether departure from adherence to that value, which includes the possibility of adjudication of QF contracts by an administrative agency, comports with constitutional ideals and the embedded value for efficiency in the common law.

2. *The Formalism of* Northern Pipeline

In the *Northern Pipeline* case, Northern Pipeline Company (Northern) filed a petition for reorganization in the United States Bankruptcy Court for the District of Minnesota.[316] Several months later, pursuant to the Bankruptcy Act of 1978[317] (Act), Northern filed a suit in that court against Marathon Pipe Line Company (Marathon) seeking damages for alleged breaches of contract and warranty, as well as for alleged misrepresentation, coercion, and duress.[318] Marathon sought dismissal of the suit on the ground that the Act unconstitutionally conferred Article III judicial power upon bankruptcy judges who lacked life tenure and protection against salary reduction.[319] The bankruptcy judge denied the motion to dismiss. On appeal, the district court entered an order granting the motion on the ground that "the delegation of authority in [the Act] to the Bankruptcy Judges to try cases which are otherwise relegated under the Constitution to Article III judges" was unconstitutional.[320]

A divided Supreme Court (four separate opinions were issued and none commanded a majority) agreed the Act was unconstitutional. The plurality opinion exposed deep divisions in the Court regarding

316. Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 56 (1982).
317. 28 U.S.C.A. §§ 1471-1482 (1982 & Supp. V 1987).
318. *Northern Pipeline*, 458 U.S. at 56.
319. *Id.*
320. *Id.* at 57 (quoting the district court's opinion).

how to determine the constitutionality of adjudications by non-Article III tribunals.[321] The plurality opinion by Justice Brennan (joined by Justices Marshall, Blackmun, and Stevens) reconciled the literal language of Article III with the reality of historical adjudications by non-Article III tribunals. It developed a taxonomy of adjudications that would sort out whether any such adjudication was constitutional or not. The Brennan majority essentially said that all adjudications by Article III courts were constitutional and that all adjudications by non-Article III tribunals were not — unless they fit into one of three categories in which "the Court has recognized certain exceptional powers bestowed upon Congress by the Constitution or by historical consensus."[322] The three categories identified by the plurality included adjudications by territorial courts, adjudications by military courts, and adjudications by other non-Article III tribunals if they involved "public rights."[323]

The Brennan plurality concluded that adjudication of the contract claims of Northern had not been done by an Article III court so it could only be constitutional if it fit into one of the three categories. The contract claim was adjudicated by a bankruptcy court, not a territorial or military court. That left only one possibility — whether a "public right" had been involved. The plurality conceded that "the distinction between public rights and private rights has not been definitively explained in our precedents,"[324] but concluded that "the substantive legal rights at issue in the present action cannot be deemed 'public rights.' "[325]

The Rehnquist concurrence, joined by Justice O'Connor, did not accept the plurality's position that the legal issue was the constitutionality of the entire Bankruptcy Act. They refused to be drawn into the larger debate between the plurality and Justice White's dissent over the constitutional contours of Article III. Rehnquist wrote:

> Particularly in an area of constitutional law such as that of "Art. III Courts," with its frequently arcane distinctions and confusing precedents, rigorous adherence to the principle that this Court should decide no more of

321. For near-contemporaneous analyses of *Northern Pipeline* see Martin H. Redish, *Legislative Courts, Administrative Agencies, and the* Northern Pipeline *Decision*, 1983 DUKE L.J. 197; Maryellen Fullerton, *No Light at the End of the Pipeline: Confusion Surrounds Legislative Courts*, 49 BROOK. L. REV. 207 (1983); and Kenneth T. Kristl, *Limits on Legislative Court Judicial Power: The Need for Balancing Competing Interests*, 59 CHI.-KENT L. REV. 873 (1984).

322. *Northern Pipeline*, 458 U.S. at 70.

323. *Id.* at 64, 66-67.

324. *Id.* at 69.

325. *Id.* at 71.

a constitutional question than is absolutely necessary accords with both our decided cases and with sound judicial policy.[326]

He went on to say:

> I need not decide whether these cases in fact support a general proposition and three tidy exceptions, as the plurality believes, or whether instead they are but landmarks on a judicial "darkling plain" where ignorant armies have clashed by night, as JUSTICE WHITE apparently believes them to be. None of the cases has gone so far as to sanction the type of adjudication to which Marathon will be subjected against its will under the provisions of the 1978 [Bankruptcy] Act.[327]

Nevertheless, Rehnquist also addressed the "public rights" issue and concluded that, "To whatever extent different powers granted under that Act might be sustained under the 'public rights' doctrine . . . , I am satisfied that the adjudication of Northern's lawsuit cannot be so sustained."[328]

Importantly for our inquiry, a majority of the court seemed to agree that an action in contract is an action at common law that should be heard by a state court and, if it is to be heard by a federal court, it should be heard by an Article III court.[329] The plurality rejected the argument that the linkage between federal restructuring of debtor-creditor relations and the adjudication of private contract claims transformed the state-created right into a matter between the government and the petitioner for reorganization. The plurality reasoned that, even in the absence of the federal scheme, the plaintiff would be able to proceed against the defendant on the state-law contractual claims.[330] The plurality then concluded that:

> [T]he Bankruptcy Act of 1978 carries the possibility of . . . an unwarranted encroachment [on the judicial power of Article III courts]. Many of the rights subject to adjudication by the Act's bankruptcy courts . . . are

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326. *Id.* at 90 (Rehnquist, J. and O'Connor, J., concurring).
327. *Id.* at 91.
328. *Id.* (citation omitted).
329. As the plurality noted:

> Appellants argue that a discharge in bankruptcy is indeed a "public right," similar to such congressionally created benefits as "radio station licenses, pilot licenses, or certificates for common carriers" granted by administrative agencies. . . . But the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a "public right," but the latter obviously is not. Appellant Northern's right to recover contract damages to augment its estate is "one of private right, that is, of the liability of one individual to another under the law as defined."

Northern Pipeline, 458 U.S. at 71-72 (citing Crowell v. Benson, 285 U.S. 22, 51 (1932)).

Three years later a majority comprised of the concurrence and dissent in *Northern Pipeline* summarized the holding of *Northern Pipeline* as establishing "that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review." Thomas v. Union Carbide Agric. Prod., 473 U.S. 568, 584 (1985).

330. *Northern Pipeline*, 458 U.S. at 72 n.26.

> not of Congress' creation. Indeed, the cases before us, which center upon appellant Northern's claim for damages for breach of contract . . . involve a right created by *state* law, a right independent of and antecedent to the reorganization petition that conferred jurisdiction upon the Bankruptcy Court. Accordingly, Congress' authority to control the manner in which that right is adjudicated, through assignment of historically judicial functions to a non-Art. III "adjunct," plainly must be deemed at a minimum. Yet it is equally plain that Congress has vested the "adjunct" bankruptcy judges with powers over Northern's state-created right that far exceed the powers that it has vested in administrative agencies that adjudicate only rights of Congress' own creation.[331]

Justice Rehnquist's concurrence was brief and direct and focused on the common-law contract nature of the claim made by Northern:

> Marathon has simply been named defendant in a lawsuit about a contract. . . .
>
> . . . From the record before us, the lawsuit in which Marathon was named defendant seeks damages for breach of contract, misrepresentation, and other counts which are the stuff of the traditional actions at common law tried by the courts at Westminster in 1789. There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims of Northern arise entirely under state law. No method of adjudication is hinted, other than the traditional common-law mode of judge and jury. . . .
>
> The cases . . . do not admit of easy synthesis. . . . None of the cases has gone so far as to sanction the type of adjudication to which Marathon will be subjected against its will under the provision of the 1978 Act. . . . I am satisfied that the adjudication of Northern's lawsuit cannot be so sustained.[332]

Justice White's dissent (joined by Chief Justice Burger and Justice Powell) agreed with the concurring justices that the only issue that should have been before the Court was the state law objection, but disagreed with the majority's conclusion on the issue.[333] White wrote: "In theory and fact, therefore, I can find no basis for that part of the majority's argument that rests on the state-law character of the claim involved here."[334] Justice White's dissent vigorously attacked the plurality's opinion and rejected the formalistic structure

331. *Id.* at 84 (footnote omitted).
332. *Id.* at 89-91 (Rehnquist, J. and O'Connor, J. concurring).
333. Justice White wrote in his dissent:

> The new aspect of the Bankruptcy Act of 1978, in this regard, therefore, is not the extension of federal jurisdiction to state-law claims, but its extension to particular kinds of state law claims, such as contract cases against third parties. . . . The old limits were based, of course, on the restrictions implicit within the concept of *in rem* jurisdiction; the new extension is based on the concept of *in personam* jurisdiction . . . . The majority at no place explains why this distinction should have constitutional implications."

Id. at 97.
334. *Id.* at 100 (White J., dissenting).

developed by Brennan. In its place, White offered a pragmatic balancing approach, which he claimed stood behind many of the decisions upholding non-Article III courts.[335]

Justice White did not identify the Article III values that he would balance. In an effort to be more "concrete," he stated that the presence of appellate review by an Article III court will go a long way toward insuring a "proper separation of powers."[336] He gave no guidance on how to identify the Article III values to be balanced, how to do the balancing, or how to distinguish a "proper" from an "improper" separation of powers. As to the limits of such balancing, Justice White did draw a line by agreeing with Chief Justice Vinson's decision in *National Mutual Insurance Co. v. Tidewater Transfer Co.* that, "the Court should guard against any congressional attempt 'to transfer jurisdiction . . . for the purpose of emasculating' constitutional courts."[337]

Of significance to our argument, the separate dissenting opinion of Chief Justice Burger intended to make clear that the plurality opinion was *not* the holding of the Court:

> Rather, the Court's holding is limited to the proposition stated by Justice Rehnquist in his concurrence in the judgment—that a "traditional" state

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335. White continues:

> There is no difference in principle between the work that Congress may assign to an Art. I court and that which the Constitution assigns to Art. III courts. Unless we want to overrule a large number of our precedents upholding a variety of Art. I courts—not to speak of those Art. I courts that go by the name of "administrative agencies"—this conclusion is inevitable. It is too late to go back that far; too late to return to the simplicity of the principle pronounced in Art. III and defended so vigorously and persuasively by Hamilton in The Federalist Nos. 78-82.
>
> To say that the Court has failed to articulate a principle by which we can test the constitutionality of a putative Art. I court, or that there is no such abstract principle, is not to say that this Court must always defer to the legislative decision to create Art. I, rather than Art. III, courts. Article III is not to be read out of the Constitution; rather, it should be read as expressing one value that must be balanced against competing constitutional values and legislative responsibilities. This Court retains the final word on how that balance is to be struck.

Id. at 113. Two pages later, inflation had taken its toll and the "one value" expressed in Article III that Justice White wanted to balance had multiplied to "values," without adding clarity on how to do the balancing:

> I do not suggest that the Court should simply look to the strength of the legislative interest and ask itself if that interest is more compelling than the values furthered by Art. III. The inquiry should, rather, focus equally on those Art. III values and ask whether and to what extent the legislative scheme accommodates them or, conversely, substantially undermines them. The burden on Art. III values should then be measured against the values Congress hopes to serve through the use of Art. I courts.

Id. at 115.

336. *Id.*

337. *Id.* at 115-16 (White, J., dissenting) (quoting *National Mutual Ins. Co. v. Tidewater Transfer Co.*, 337 U.S. 582, 644 (1948)).

> common-law action, not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law, must, absent the consent of the litigants, be heard by an "Art. III court" if it is to be heard by any court or agency of the United States.[338]

What emerges from this dialogue is that all opinions of the Court appear to adopt state common law adjudication of contracts as a significant Article III value. This value is expressed most directly in the opinion of the *Northern Pipeline* plurality, which quoted from *Murray's Lessee v. Hoboken Land & Improvement Co.*: " '[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty; nor, on the other hand, can it bring under the judicial power a matter which, from its nature, is not a subject for judicial determination.' "[339] The plurality's taxonomy does not identify the value as affirmatively but instead uses it to determine that a public right is not involved. The plurality, without being specific, describes the state contract claim at issue as a "substantive legal right," in all likelihood referring to the common-law aspect of the contract claim. The dissent also recognizes the state law claim as a value. Regrettably for this thread of our analysis, the dissent recognizes it as a value to be balanced against the legislative interests in creating specialized non-Article III courts to meet specialized needs. This is, perhaps, an evolutionary regression. But even the dissent highly qualifies the availability of this value for balancing. The dissent would allow it to be balanced provided the Court retains judicial review to police legislative excesses and, even under these circumstances, only "comparatively minimal" encroachment on state law questions would be acceptable.[340]

3. *The Functionalism of* Thomas *and* Schor

Four years later, the Supreme Court revisited the issue of whether a non-Article III tribunal could adjudicate a state common law contract claim in *Schor* and came to a different conclusion than it reached in *Northern Pipeline*.[341] In *Schor*, the CFTC assumed jurisdiction over state common law contract counterclaims through promulgation of a regulation that allowed it to adjudicate counterclaims

338. *Id.* at 92 (Burger, J. dissenting).
339. *Id.* at 67 (quoting Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. 272, 284 (1855)).
340. *Id.* at 100.
341. For commentary on *Schor* see Richard B. Saphire & Michael E. Solimine, *Shoring Up Article III: Legislative Court Doctrine in the Post* CFTC v. Schor *Era*, 68

arising out of the transaction or occurrence, or series of transactions or occurrences, set forth in the reparations complaint.[342]

Subsequently, the CFTC received a complaint from Schor against a broker under its regulatory authority. Schor sought reparations of funds it alleged had been lost due to the broker's numerous violations of the Commodities Exchange Act.[343] The broker had a complaint of his own against Schor for non-payment of a debit balance on the same account. Unaware of the reparations complaint, the broker filed a diversity action for recovery of the debit balance in U.S. district court. Schor sought dismissal or stay of the district court action. The court declined to dismiss or stay but the broker voluntarily dismissed the federal court action, presenting its debit balance claim by way of a counterclaim in the CFTC reparations proceeding.

The CFTC Administrative Law Judge (ALJ) held for the broker. Schor then challenged the CFTC's statutory authority to adjudicate the broker's counterclaim. The ALJ rejected the challenge. The CFTC declined to review the decision. Schor filed a petition for review with the court of appeals. The court of appeals, *sua sponte*, raised the question of whether the CFTC could constitutionally adjudicate the broker's counterclaims in light of the Supreme Court's decision in *Northern Pipeline.*

The court of appeals found for the broker in most respects, but ordered the dismissal of the broker's counterclaims on the ground that the CFTC lacked authority to adjudicate common law counterclaims.[344] The CFTC appealed to the Supreme Court. The Court granted the petition for certiorari,[345] vacated the court of appeal's judgment, and remanded the case for further consideration in light of the Court's then-recent disposition of *Thomas v. Union Carbide Agricultural Products Co.*[346] On remand, the court of appeals reinstated its prior judgment. It reaffirmed its earlier view that *Northern Pipeline* drew into serious question the CFTC's authority to decide

B.U. L. REV. 85 (1988); Daniel P. Sedor, Commodities Futures Trading Commission v. Schor: *Article III Finds a Home on the Slippery Slope*, 21 LOY. L.A. L. REV. 707 (1988); Peter L. Strauss, *Formal and Functional Approaches to Separation of Powers Questions—A Foolish Inconsistency?*, 72 CORNELL L. REV. 488 (1987); Ralph U. Whitten, *Consent, Caseload, and Other Justifications for Non-Article III Courts and Judges: A Comment on* Commodities Futures Trading Commission v. Schor, 20 CREIGHTON L. REV. 11 (1986-87); Gordon G. Young, *Public Rights and the Federal Judicial Power: From* Murray's Lessee *Through* Crowell *to* Schor, 35 BUFF. L. REV. 765 (1986).

342. 17 C.F.R. § 12.23(b)(2) (1992).

343. 7 U.S.C. §§ 1-26 (1988).

344. Schor v. Commodity Futures Trading Comm'n, 740 F.2d 1262 (1984), *cert. granted*, 478 U.S. 833 (1986).

345. *Id.*

346. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

debit-balance counterclaims in reparations proceedings and concluded that nothing in *Thomas* altered that view.[347]

The significance of *Thomas* to the Court was that, in a decision which garnered a majority of five justices and concurrences by the rest, the Court essentially applied the balancing approach advocated by Justice White's dissent in *Northern Pipeline.* The Court's ruling in *Thomas* held that the arbitration scheme established under the Federal Insectide, Fungicide, and Rodenticide Act (FIFRA)[348] did not contravene Article III.[349] More generally, it also held that, "Congress acting for a valid legislative purpose pursuant to its constitutional powers under Article I, may create a seemingly 'private' right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary."[350] The Court expressed the view that "[t]o hold otherwise would be to erect a rigid and formalistic restraint on the ability of Congress to adopt innovative measures such as negotiation and arbitration with respect to rights created by a regulatory scheme."[351]

Justice Stevens concurred in the *Thomas* judgment but never reached the merits because he felt there was a problem with standing. Justices Brennan, Blackmun, and Marshall concurred in the judgment, but on the basis that the issue in *Thomas* involved a public right and that, therefore, the case was amenable to the analysis and formal structure of the plurality's analysis in *Northern Pipeline.* The remaining five Justices (those who had concurred with the plurality in *Northern Pipeline* plus the dissenters in *Northern Pipeline*) concluded that *Northern Pipeline* was not applicable because there was no state law claim at issue. The Justices concluded that the right at issue was not a purely "private" right, but bore many characteristics of a "public" right. Eschewing "doctrinaire reliance" on formal categories and embracing "practical attention to substance," the Court balanced the weighty concerns motivating Congress in establishing the arbitration scheme against the assessment of minimal encroachment on Article III judicial powers plus the preservation of some judicial review.[352]

347. Schor v. Commodity Futures Trading Comm'n, 770 F.2d 211 (1985), *rev'd*, 478 U.S. 833 (1986).
348. 7 U.S.C. §§ 136-149 (1988).
349. Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568 (1985).
350. *Id.* at 593-94.
351. *Id.* at 594.
352. *Id.* at 587.

Perhaps the Supreme Court was expecting the court of appeals to apply the majority-endorsed balancing approach of *Thomas* to *Schor* when it remanded. The problem was that the court of appeals was responding to the Article III value upon which a majority of the Justices agreed with in *Northern Pipeline* — that an action in contract was a common-law right that could not be intruded upon by a non-Article III tribunal. Since *Schor* presented exactly the same issue in that regard, the court of appeals did not have to choose between the formalistic structure of Justice Brennan's plurality in *Northern Pipeline* and Justice White's balancing approach in dissent. Therefore, on remand, it reaffirmed its earlier decision that the CFTC could not adjudicate the common-law counterclaim.

The Supreme Court had, however, already crossed the rubicon in *Thomas*. In considering an application for registration of a similar product by another registrant, FIFRA authorized the Environmental Protection Agency (EPA) to consider certain previously submitted data only if the "follow-on" registrant offered to compensate the original registrant for use of the data. FIFRA further provided for binding arbitration if the registrants failed to agree on compensation. There was such a failure to agree. The registrant who felt undercompensated by the arbitration award challenged the constitutionality of the arbitration provisions on the ground that they violated Article III by allocating to arbitrators the functions of judicial officers and by limiting review by an Article III court.

The arbitrators were adjudicating claims between private parties, the registrants, but the claims did not arise from state created common-law rights. Rather, they derived from FIFRA. In other words, but for FIFRA, there would be no claim since there was no independent actionable right at common law. Since the two concurring Justices in *Northern Pipeline* could not find "the stuff of traditional actions at common law tried by the courts at Westminster in 1789"[353] in *Thomas*, they had to choose between the formalism of *Northern Pipeline's* plurality or the functionalism of *Northern Pipeline's* dissent, which would balance the legislative interest against the incursion into Article III judicial power. They chose the latter.

Therefore, by the time *Schor* had to be decided, the Court had a majority that felt comfortable balancing Article III values in a case involving private rights, albeit not a common-law private right. Also by this time, the Court's policy toward judicial review of administrative agencies had evolved into the now-labeled *Chevron* deference.[354]

353. Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 90 (1982).

354. Indeed the Court in *Schor* stated:

> As our discussion makes manifest, the CFTC's long-held position that it has the power to take jurisdiction over counterclaims . . . is eminently reasonable

In reversing the court of appeals in *Schor*, the Supreme Court identified the factors that had to be considered in the balancing: (1) the extent to which "essential attributes of judicial power" are reserved to Article III courts; (2) the extent to which the non-Article III forum exercises the range of jurisdiction and powers normally vested only in Article III courts; (3) the origins and importance of the right to be adjudicated; and (4) the concerns that drove Congress to depart from the requirements of Article III.[355]

In enumerating the factors to be balanced, the Court identified that the nature of the claim to be adjudicated, a state common law contract action, was an Article III value. The Court wrote, "The counterclaim asserted in this litigation is a 'private right' for which state law provides the rule of decision. It is therefore a claim of the kind assumed to be at the 'core' of matters normally reserved to Article III courts."[356] Nevertheless, the Court concluded that, "there is no reason inherent in separation of powers principles to accord the state law character of a claim talismanic power in Article III inquiries."[357] But the Court equivocates when it says:

> the state law character of a claim is significant for purposes of determining the effect that an initial adjudication of those claims by a non-Article III tribunal will have on the separation of powers for the simple reason that private, common law rights were historically the types of matters subject to resolution by Article III courts.[358]

The Court then approved of "limited CFTC jurisdiction over a narrow class of common law claims as an incident to CFTC's primary, and unchallenged, adjudicative function" and concluded that such incursion into Article III judicial power "does not create a substantial threat to the separation of powers."[359] *Northern Pipeline* is distinguished by the fact that the defendant in the state common law

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> and well within the scope of its delegated authority. Accordingly, as the CFTC's contemporaneous interpretation of the statute it is entrusted to administer, considerable weight must be accorded the CFTC's position. *See Chevron U.S.A. Inc. v Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844-845 (1984) . . . .

Schor v. Commodity Futures Trading Comm'n, 478 U.S. 833, 844 (1986).

355. *Schor*, 478 U.S. at 851. The "balancing" of these factors, as in other judicial balancing, i.e. Mathews v. Eldridge, 424 U.S. 319 (1976), is essentially a cost/benefit analysis. This approach has been criticized from the perspective that the "Court has no right to 'balance' an Article III requirement on the grounds of expediency." Bator, *supra* note 309, at 257. In other words, the structure of the Constitution is not available for balancing.

356. *Schor*, 478 U.S. at 853.

357. *Id.*

358. *Id.* at 854.

359. *Id.*

contract action did not consent to the non-Article III adjudication and that the assertion of judicial power by the bankruptcy courts was over all civil claims related to the bankruptcy. In contrast, in *Schor*, the defendant in the state common law counterclaim *consented*[360] to the jurisdiction of the non-Article III tribunal and the judicial power asserted by the CFTC was only with respect to the more limited area of counterclaims.

4. *Implications*

A value which emerged in *Murray's Lessee* is that "any matter which from its nature, is the subject of a suit at common law" is most appropriately within the judicial cognizance of Article III courts. That value reached its zenith in the absolutism of the Rehnquist concurrence in *Northern Pipeline*. It was obscured in *Thomas. Schor* was its nadir but *Granfinanciera*[361] marks its re-ascendance. However, even with the utilitarian balancing approach of *Schor*, it nonetheless appears that adjudication of QF contracts by a non-Article III court would be an impermissible incursion into the judicial power of Article III courts.

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360. However, the Court qualified this aspect:

> To the extent that this structural principle [checks and balances] is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III, section 2. [citation omitted]. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.

Schor, 478 U.S. at 850-51.

361. In *Granfinanciera, S.A. v. Nordberg*, 294 U.S. 33 (1989), the Court, in an opinion written by Justice Brennan, held that the Seventh Amendment ("In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved.") prohibits the adjudication of a "private right," i.e., a common law right of action, by a non-Article III tribunal. Consequently, *Granfinanciera* limits the effect of *Schor*. Several noted commentators have assessed this limitation as follows:

> In a footnote, the majority appears to distinguish *Schor* on the ground that because the disgruntled consumer elected to pursue a remedy from the CFTC, rather than a district court, the person waived the right to have any counterclaims by the broker determined by an Article III judge. This suggests, however, that if a litigant does not make such a waiver, a jury trial would be required. If so, *Granfinanciera* would constitute an important limitation on the scope of *Schor*. If the Seventh Amendment requires a jury trial in any case where a public right is not involved, the *Schor* balancing test will not uphold any cases that a straight public/private law test will not also uphold. Thus, the Court appears in effect to have returned to the public/private rights distinction that it appeared to have abandoned in *Schor*.

RICHARD J. PIERCE ET AL., ADMINISTRATIVE LAW AND PROCESS 75 (2d ed. 1992).

Brennan's views on the public/private rights distinction appear to have ultimately prevailed. *Granfinanciera* strengthened the basis for his structural approach in *Northern Pipeline* and it undermined *Schor*. For a critical commentary on *Granfinanciera* see Bernard Schwartz, *"Apotheosis of Mediocrity"? — The Rehnquist Court and Administrative Law*, 46 ADMIN. L. REV. 141, 153 (1994).

Contracts between a QF and an investor-owned utility are varied. Some have been freely negotiated between the parties. Some have been standard form contracts made available by the utility at the order of the public utility commission as a backup option to failed negotiations. Some have received review and approval by the appropriate state regulatory authority. Some may derive from independent state authority and others derive from the mandate of PURPA. Qualifying Facility status does not ensure that a contract will be entered into by the utility, nor does it give the contract any special status. Rather, it exempts the QF from otherwise applicable rate-of-return regulation and guarantees a market for the facility's generated electricity whether under contract or not. In other words, a QF contract is just a contract for the sale of electricity by a private party to another private party. Such a contract is subject, like all other contracts, to the common law of contracts in its formation, performance, and enforcement.

The concern of this article about adjudication of these contracts by a non-Article III tribunal is a concern about contractual adjudication by FERC or a state regulatory authority, typically a public utility commission. It is clear from the judicial review provisions discussed in Section III.C that Congress provided for judicial review by state courts and Article III courts. There is, however, an indefiniteness about the extent of the authority to be exercised by FERC with respect to the review provided for in PURPA[362] and with respect to review by state regulatory authorities pursuant to FERC's implementing regulations, which are permissive of an "undertaking to resolve disputes between qualifying facilities and electric utilities."[363]

Any contractual adjudication by FERC pursuant to the review authorized by PURPA would, of course, directly confront the issue of the limitations on such adjudication by Article III. More precisely, it

362. 16 U.S.C. § 2633 (1988).

363. FERC's Enforcement Policy Statement appears to equate "an undertaking to resolve disputes" with case-by-case determinations by the state regulatory authority. In this regard it is a description of a process, not a substantive grant of authority. Nonetheless, as described in Section III.C, state regulatory authorities have in effect implemented this provision as if it were a substantive grant of authority to adjudicate contract disputes. This issue is under litigation. *See* Independent Energy Producers Ass'n v. California Pub. Util. Comm'n, No. C-91-2644-MHP (N.D. Cal. filed Aug. 15, 1991) (memorandum and order denying the Commission's Motion for Summary Judgment to Dismiss for Lack of Federal Subject Matter Jurisdiction, Nov. 15, 1991). At issue is whether the CPUC can authorize the electric utilities to terminate their power-purchase contracts with the QF upon the unilateral determination by the utility of non-compliance with a contract warranty that the seller (the QF) will at all times during performance of the contract maintain compliance with FERC's qualifying facility certification criteria.

would confront the Supreme Court's most recent pronouncements on the exercise of Article III judicial authority by non-Article III tribunals. Private rights were at issue in *Northern*, *Thomas* and *Schor*, but each involved a different model against which the QF contract must be measured. *Northern* was easily the most "private" of them. The only public nexus was the attempted jurisdiction by the bankruptcy court of all civil proceedings related to the bankruptcy. A QF contract is not similarly "private." For one thing, it has the public nexus of the regulatory scheme described in Section II. Thus, it may appear to be closer to the model of the "private right," with characteristics of a "public right" that the Court considered in *Thomas*. That is, a "seemingly 'private' right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution, with limited involvement by the Article III judiciary."[364]

The comparison, however, does not withstand scrutiny. The FIFRA scheme in *Thomas* was totally federalized. Federal law required the relationship. Federal law prescribed the terms of compensation and the procedures for arriving at the proper amount of compensation in any given case. The judicial review provided was limited but exclusively federal. No action at common law could lie regarding this federally created right. PURPA does not fit this model either.

While PURPA requires a relationship, that of buyer and seller, it does not require a contractual relationship.[365] PURPA prescribes the concept of avoided cost for compensation but leaves procedures for its determination to the appropriate state regulatory authority. Although it could be said that PURPA implementation by the appropriate state regulatory authority has, in some states, resulted in a required contractual relationship, the PURPA provision for judicial review by state courts anticipates the application of the state's common law of contracts since a federal common law of contracts is underdeveloped.[366] In short, although PURPA may have created a "private right" as did FIFRA, PURPA does not provide a federal rule of decision, as did FIFRA, for resolution of private rights in dispute. In contrast to a fully federalized scheme, PURPA contemplates state court adjudication of contract claims.

Since PURPA does not involve a "private right" as in *Northern Pipeline*, and since PURPA is sufficiently different from FIFRA so

364. Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 593-94 (1985).

365. 18 C.F.R. § 292.304(d) (1992).

366. Kevin R. Johnson, *Bridging the Gap: Some Thoughts About Interstitial Lawmaking and the Federal Securities Laws*, 48 WASH. & LEE L. REV. 879, 884-90 (1991). "In more recent years the Court . . . has been hesitant to read a statute as authorizing federal common lawmaking. . . . In sum, the influence of federalism, separation of powers and fear of judicial lawmaking are evident in some, though not all, of the Supreme Court's federal common law decisions." *Id.* at 889-90.

that *Thomas* does not apply, we must seek the measure of PURPA against the standard of *Schor*. Weighing the *Schor* factors to determine whether FERC could adjudicate contract disputes resulting from PURPA implementation is more straightforward than weighing the same factors with respect to CFTC regulation providing CFTC jurisdiction over counterclaims. First, the "essential attributes of judicial power" are reserved to Article III courts by the provisions for judicial review. Second, Congress never departed from the requirements in Article III when it adopted PURPA. There is nothing in PURPA that even hints at the allocation of Article III judicial power to FERC. Third, the origin and importance of the right to be adjudicated, that is the nature of the claim, is one that should be the subject of a searching examination.[367] In this instance, it is a common law contract action.[368] Therefore, there is nothing in the balancing of these factors that would result in a finding that would sustain FERC's adjudication of a QF contract dispute, which is, after all, no more than a common law claim that should be heard before the courts.[369] Finally, if we add to *Schor's* explicit factors the weighing of the embedded value for efficiency inherent in common law contract adjudication,[370] it would seem clear that adjudication of QF-

367. Schor v. Commodity Futures Trading Comm'n, 478 U.S. 833, 854 (1986).

368. "Even where a regulatory body claims 'primary jurisdiction' over some aspect of the dispute, the issue of contract liability is still within the jurisdiction of the courts. Courts apply the common law." Susan Zachos, *Gas Purchase Contracts: Equitable Remedies for Breach*, 24 HOUS. L. REV. 991, 1001 (1987). See also Royal Resources Exploration, Inc. v. Pacific Gas & Elec. Co., 43 F.E.R.C. ¶ 61,049 (1988), in which PG&E argues that the Commission should dismiss the complaint because, among other things, "the complaint is a contract dispute involving contract interpretation and state law which should be resolved by arbitration or in a state court." *Id.* ¶ 61,138. The Commission dismissed the complaint stating, "As noted, the dispute is largely one of a factual and contractual nature which is best resolved by the parties or in a court of competent jurisdiction." *Id.* ¶ 61,139. See also Farmland Industries Inc. v. Louisiana Intrastate Gas Corp., 56 F.E.R.C. ¶ 61,257 (1991) where the Commission states, "Since the issues presented in the complaint are within the competence of the courts, the Commission has no responsibility to afford a forum for the resolution of this contract dispute." *Id.* ¶ 61,954.

369. At least one federal agency has recently addressed the issue of the extent to which it could constitutionally adjudicate an action which would impose liability based on a common law theory. It concluded that "The nature and intent of the action is not the problem. The forum is the problem . . . an administrative agency cannot impose personal liability on a common law basis. That authority is vested exclusively in Article III courts." Bayport Refining Co., 51 F.E.R.C. ¶ 63,011 (1990). In relevant part it cited Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982).

370. It has been argued that common law judges should be influenced by social values about which there is a consensus and that efficiency is, presumably, such a value. *See* COOTER & ULEN, *supra* note 281, at 497 n.23, *citing* MELVIN A. EISENBERG, A THEORY OF ADJUDICATION (forthcoming). It appears highly likely that the cited work

utility contracts by an administrative agency should be impermissible.

B. *Federalism, Preemption, and the Common Law*

A construction of PURPA that would authorize the CPUC to *adjudicate* contract disputes between QFs and utilities might very well make PURPA constitutionally infirm on the grounds that it violates the Tenth Amendment and the Guarantee Clause.[371] Such a construction would reallocate judicial power to adjudicate contract disputes already allocated by the California Constitution and subsequent legislative acts.[372] Since it is a well-settled rule of statutory construction that, where possible, statutes should be interpreted to preserve their constitutionality, a construction of PURPA that directs QF-utility contract disputes first to the state and then to adjudicatory forums within the state (according to that state's constitutional and statutory judicial powers scheme) is to be preferred.[373]

Although *FERC v. Mississippi*[374] has been cited[375] for a construction suggesting support for CPUC adjudication of contract disputes and, therefore, for presupposing that PURPA has been cleared of any federalism problem in such an adjudication, a close reading of

appeared as MELVIN A. EISENBERG, THE NATURE OF THE COMMON LAW (1988). See in particular the discussion on Moral Norms in Chapter 4, titled Social Propositions.

371. The amorphousness, uncertainty, and unpredictability of Article III jurisprudence is matched by the state of the law in the Tenth Amendment and Guarantee Clause areas which has been characterized as "Now you see it, Now you don't, Oops! Yes you do." Amy K. Kelley-Pittman, *Resurgent Federalism Issues in Natural Resources Law, in* SEVENTH INSTITUTE FOR NATURAL RESOURCES LAW TEACHERS, Paper No. 10 at 6 (Rocky Mt. Min L. Fdn. 1993). The Supreme Court has itself described such jurisprudence as having "traveled an unsteady path." New York v. United States, 112 S.Ct. 2408, 2420 (1992). In at least one area, complex environmental laws, which require some state involvement in their implementation, the Court appears to be converging on a concept it finds acceptable, "cooperative federalism." *See Project: The Role of Preemption in Administrative Law,* 45 ADMIN. L. REV. 107, 195-222 (1993). For a federalism based on the Guarantee Clause, see Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century,* 88 COLUM. L. REV. 1 (1988).

372. The Supreme Court has overridden some state court procedural requirements that have in effect affected state court jurisdiction. These cases, however, have involved procedural rules of state courts and appear to be limited to the implementation of the Federal Employer's Liability Act (FELA). *See* Dice v. Akron, Canton & Youngstown R.R. Co., 342 U.S. 359 (1952); Brown v. Western Ry., 338 U.S. 294 (1949).

373. As one scholar has written: "The general rule, bottomed deeply in belief in the importance of state control of state judicial procedure, is that federal law takes the state courts as it finds them." Henry M. Hart, Jr., *The Relations Between State and Federal Law,* 54 COLUM. L. REV. 489, 508 (1954).

374. Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742 (1982).

375. *See In re* Southern Cal. Gas Co., 1991 Cal. PUC LEXIS 232, at *10 (1991); Independent Energy Producers Assoc. v. California Pub. Util. Comm'n, No. 91-2466-MHP) (N.D. Cal. filed Aug. 15, 1991) (Intervenor Utilities' Memo of Points and Authorities in Support of Joint Motion to Dismiss for Lack of Subject Matter Jurisdiction or in the Alternative for Summary Judgment, Feb. 13, 1992, at 24).

that Supreme Court decision shows that such a construction was not addressed. If anything, the decision implies otherwise. In *FERC v. Mississippi*, the State of Mississippi and the Mississippi Public Service Commission brought an action in U.S. district court against FERC and the Secretary of Energy seeking a declaratory judgment that Title I, Section 210 of Title II, and Title III of PURPA were unconstitutional because they exceeded congressional power under the Commerce Clause and constituted an invasion of state sovereignty in violation of the Tenth Amendment. Titles I and III required state utility regulatory commissions to consider federal rate design and regulatory standards and required state commissions to follow certain notice and comment procedures when acting on the federal standards. Section 210 of Title II sought to encourage development of cogeneration and small power production facilities by authorizing FERC to exempt qualified facilities from state laws and regulations and by requiring that state authorities implement FERC's rules developed to carry out these goals. The district court held for the plaintiffs but was reversed on direct appeal to the Supreme Court.[376] The Supreme Court decision contained three opinions and the prevailing one commanded a bare majority.

The Supreme Court had little difficulty in holding that PURPA legitimately preempted state authority, but even the majority had some concerns with the issue of federalism posed by PURPA's prescription of administrative and judicial procedures. The majority, however, overcame its concerns by relying heavily on *Testa v. Katt*.[377] In *Testa*, a federal statute that created a treble-damages remedy for violations of the statute gave jurisdiction to state as well as federal courts. The state of Rhode Island refused to enforce the federal statute. The Supreme Court held that the state courts were not free to refuse enforcement of the statute.

In its Section 210 analysis in *FERC v. Mississippi* the Supreme Court concluded that "*Testa v. Katt* is instructive and controlling on this point."[378] The Court was referring to the "troublesome" requirement that " 'each State regulatory authority shall, after notice and opportunity for public hearing, *implement* such rule (or revised rule) for each electric utility for which it has ratemaking authority.' "[379]

376. Mississippi v. Federal Energy Regulatory Comm'n, 38 P.U.R. 4th 284 (1981), *rev'd*, 456 U.S. 742 (1982).
377. 330 U.S. 386 (1947).
378. Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 760 (1982) (citations omitted).
379. *Id.* at 759 (quoting PURPA § 210, *supra* note 12).

The Supreme Court reasoned that *Testa* was applicable because FERC also declared that state commissions could implement Section 210 by, among other things, "an undertaking to resolve disputes between qualifying facilities and electric utilities."[380] The Court then concluded that, "In essence, then, the statute and the implementing regulations simply require the Mississippi authorities to adjudicate disputes arising under the statute. Dispute resolution of this kind is the very type of activity *customarily engaged* in by the Mississippi Public Service Commission."[381] The Court then had a string of general citations to the Mississippi Public Utilities Code, none of which authorize the Mississippi Public Service Commission to adjudicate contract disputes.[382] The Court concluded that "[t]he Mississippi Commission *has jurisdiction* to entertain claims analogous to those granted by PURPA, and it can satisfy Section 210's requirements simply by opening its doors to claimants."[383] In fact, the Mississippi Public Service Commission did not customarily engage in resolution of contractual disputes, nor did it have such jurisdiction. The Mississippi Supreme Court had unequivocally stated that the Mississippi Public Service Commission did not have jurisdiction to adjudicate contract disputes.[384]

It is clear that the use of *Testa* to salvage the constitutionality of Section 210 of PURPA was accompanied by limitations of *Testa's* holding that the adjudicatory body[385] must already have jurisdiction

380. *Id.* at 759 (citing 18 C.F.R. § 292.401(a) (1980)).
381. *Id.* at 760 (emphasis added).
382. *Id.* at 760.
383. *Id.* (emphasis added).
384. Mississippi Valley Gas Co. v. DeSoto Natural Gas Dist., 235 So.2d 285, 287 (Miss. 1970) ("Jurisdiction to adjudicate the rights of the parties to this contract is in the courts, not the Public Service Commission."). In fact, under Mississippi law it has even been held that a tariff established by the Public Service Commission establishes a contractual relationship with the recipient of the utility's services and that noncompliance with that tariff is a breach of contract to be adjudicated before the courts. South Cent. Bell v. Epps, 509 So. 2d 886 (Miss. 1987). The court held:

> Accordingly, we find that the relationship between South Central Bell and its subscribers is essentially a contractual relationship. The terms of such a contract are supplied by the tariffs which have been duly filed and approved by the Mississippi Public Service Commission. From this, it logically follows that any claim alleging wrongful disconnection of telephone services must necessarily involve a breach of the subscriber's tariff or contract.

Id. at 891.

385. The Supreme Court also made the leap of applying *Testa* to an administrative agency, stating that " 'the role is 'functionally comparable' to that of a judge.' " *FERC v. Mississippi*, 456 U.S. at 760 n. 24 (1982) (quoting Butz v. Economou, 438 U.S. 478, 513 (1978)). See D. Bruce La Pierre, *The Political Safeguards of Federalism Redux: Intergovernmental Immunity and the States as Agents of the Nation*, 60 WASH. U. L.Q. 779 (1982), for criticism of this aspect of the Court's use of *Testa*. He writes:

> The second problem with the Court's reliance on *Testa* to uphold section 210 is the extrapolation of a duty of state administrative agencies to enforce national regulations by adjudicating claims from the duty of state courts to perform the same function. History provides a solid warrant for Congress' power to impose

to hear the "same type of claim arising under [state] law"[386] and that the adjudicatory body must have "jurisdiction adequate and appropriate under established local law to adjudicate [the] action."[387] The Supreme Court in *FERC* did not approve any delegation of new adjudicatory powers to the state regulatory commissions.[388] Instead, it is unmistakably clear that the Supreme Court's common understanding was that state regulatory commissions were simply being asked to apply whatever judicial powers the state had allocated to the state regulatory commissions in resolving disputes between QFs and utilities.[389] To this extent, *FERC v. Mississippi* does not provide

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> a duty on state courts to entertain claims arising under national law, but there is no similar support for national power to impose duties on state administrative agencies.

Id. at 944-45 (citations omitted).

386. Testa v. Katt, 330 U.S. 386, 394 (1947).

387. *Id.* Even with these limitations *Testa* has not escaped criticism. "In the absence of a declaration by Congress that state courts must enforce rights that Congress has created, there appears to be no substantial reason why the Supreme Court should impose such an obligation." Terrance Sandalow, Henry v. Mississippi *and the Adequate State Ground: Proposal for a Revised Doctrine*, 1965 SUP. CT. REV. 187, 207; *see also* LAURENCE H. TRIBE, CONSTITUTIONAL CHOICES (1985):

> Furthermore, as Justice Powell pointed out in his dissent, *Testa* took the state courts as it found them — it did not alter their internal procedures as PURPA does — and it limited its holding to cases where the state court already had adequate jurisdiction "under established local law" to hear the federal action.

Id. at 127.

388. Otherwise, "FERC significantly broadens the *Testa* doctrine by upholding a federally mandated commingling of federal and state policies in the development of state law. *Testa*, by contrast, did not involve federal interference with a state's own body of law." *The Supreme Court, 1981 Term*, 96 HARV. L. REV. 62, 193 (1982).

389. That this was the common understanding of the Court is evident by the fact that the Court was in consensus on the Section 210 holding. The dissents by the other four Justices were with respect to the Title I and Title II holdings. Justice Powell's reasoning in not dissenting on Section 210 is explained in an extensive discussion, in his footnote 4, of the limitations in the *Testa* holding with which he concludes: "[N]othing in *Testa* upsets 'the traditional doctrine that Congress may not interfere with a state's sovereign right to determine and control the jurisdictional requirements of its own courts.'" Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 774 n.4 (Powell, J., concurring in part and dissenting in part) (citation omitted). Justice O'Connor, writing in dissent for three justices, also explained at length why she was not dissenting with the Section 210 holding of the majority in her first footnote and concluded:

> It appears, therefore, that state regulatory authorities may satisfy § 210's implementation requirement simply by adjudicating private disputes arising under that section. As the Court points out . . . the Mississippi Public Service Commission has jurisdiction over similar state disputes, and it is settled that a State may not exercise its judicial power in a manner that discriminates between analogous federal and state causes of action [citation to *Testa*]. Under these circumstances, but without foreclosing the possibility that particular applications of § 210's implementation provision might uncover hidden constitutional

any authority for a state regulatory commission to adjudicate contractual disputes if the state itself has not provided it such authority.[390]

The impediment that federalism poses to the adjudication of contract disputes by the CPUC in the implementation of PURPA could be cured by a state reallocation of judicial authority that would grant the CPUC such adjudicatory authority. It is unlikely that the legislature would do this. If it did, however, the solution would likely raise the problem, as considered in Section III of this article, of an unconstitutional exercise of judicial power by the CPUC in contravention of the Court's *McHugh* decision.

There is, however, another way to avoid the problem of PURPA and *FERC v. Mississippi* resulting in improper intervention into the judicial authority of the state courts. This route is through preemption and application of federal common law, rather than the substantive law of the state. Instead of viewing PURPA as reallocating authority to resolve QF-utility contract disputes from the state courts to the the state regulatory commissions, one could view PURPA as preempting the entire field, a proposition that the Court did not find difficult to agree upon as a legitimate possibility in *FERC v. Mississippi*. Once it preempted the state's role, the federal government could implement PURPA directly through FERC. Assuming that the Court would find that FERC could constitutionally adjudicate QF-utility contract disputes (recall that Section IV's analysis concluded that this was doubtful), then FERC could delegate its adjudicatory authority to the state regulatory agencies.

In other words, the state regulatory commissions would be acting as federalized state tribunals. The law that such a federalized state tribunal would apply in adjudicating contract disputes would have to be the law that a federal court would apply. The federalized state rate regulatory agency could choose to apply state common law or to apply federal common law to resolve contract disputes between QFs and utilities. In the latter case, the state common law of contracts is displaced by federal common law. This presents a new problem. Since it now involves a choice with respect to applicability of the common law, which, as we have seen, has embedded within it a

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defects, I would not sustain appellee's facial attack on the provision.

Id. at 776 n.1 (O'Connor, J., dissenting).

390. Section III has analyzed the extent to which California could provide such authority. That analysis identified serious limitations. Nevertheless, adherents of an expansive view of such possibilities can point to dated authority such as Pickens v. Johnson, 42 Cal. 2d 399, 267 P.2d 801 (1954) wherein the court states: "The Public Utilities Commission has been established under a constitutional enabling act with full power conferred on the legislature to enact legislation even contrary to any other provision of the constitution provided it be cognate and germane to the regulation and control of Public Utilities." *Id.* at 404, 267 P.2d at 804.

value for efficiency, it also raises the question of the efficiency effects of such preemption.

Lincoln Mills,[391] *Ivy Broadcasting v. American Telephone & Telegraph Co.*,[392] and *Pennzoil*[393] provide interesting examples for examination of the problem since they are all major cases which deal with a similar displacement of the common law of contracts. Additionally, they all deal with federal legislation similar to PURPA, complex federal schemes with ambiguous remedial authority. In all of these cases, the courts implied congressional intent to displace the substantive law of the states with a federal common law which was to be developed by the courts. However, in *Pennzoil*, the case perhaps most similar to the situation of QF-utility contracts (and involving FERC's authority to adjudicate contracts under federal common law), the court held that FERC's authority to adjudicate contracts under federal common law was quite limited.

In *Lincoln Mills*, a labor union requested a federal court to decree specific performance of a collective bargaining contract, specifically, its arbitration clauses. The court of appeals reversed a district court which provided the union with relief. The basis for the appellate decision was that, even though the federal courts had jurisdiction, there was no source, either common law or statutory, that permitted the enforcement of a covenant for arbitration.[394] The Supreme Court eventually held that the congressional intent of the Labor Management Relations Act of 1947[395] was for the federal courts to develop a body of substantive principles of federal labor law from the legislative outline provided by Congress.[396]

Ivy Broadcasting went further. It involved an action by a user of interstate telephone service against several telephone companies for negligence and breach of contract. The court held "that private citizens have a federal common law cause of action against telephone

391. Textile Workers Union v. Lincoln Mills, 353 U.S. 448 (1957).

392. 391 F.2d 486 (2d Cir. 1968).

393. Pennzoil Co. v. Federal Energy Regulatory Comm'n, 645 F.2d 360 (5th Cir. 1981).

394. Lincoln Mills of Ala. v. Textile Workers Union, 230 F.2d 81, 88 (5th Cir. 1956).

395. The Labor Management Relations Act of 1947, 29 U.S.C. §§ 141-197 (1988).

396. FRIEDENTHAL ET AL., *supra* note 11, at 229. The Supreme Court opinion was heavily criticized in Alexander M. Bickel & Harry H. Wellington, *Legislative Purpose and the Judicial Process: The* Lincoln Mills *Case*, 71 HARV. L. REV. 1 (1957). For a more favorable review see Note, *The Federal Common Law*, 82 HARV. L. REV. 1512, 1535 (1969) ("Set against the weak presumption in favor of applying state law, the need to further national policy justifies the result in *Lincoln Mills*.").

companies even though the congressional regulatory statutes neither explicitly nor implicitly address the question of private remedies." The court based its decision on the significant national interest in the proper functioning of telephone companies.[397]

The issue in *Pennzoil* was whether state or federal contract law applied to determine whether "area rate clauses" could be sufficient contractual authority to collect ceiling prices established by federal legislation regulating natural gas. The court said that if "there is a significant conflict between the identifiable federal policy or interest and the use of state law, the state law is preempted."[398] However, the court went on to say that,

> The federal scheme of regulation under the NGA and NGPA is limited in its displacement of state regulatory authority. Unlike the Federal Communications Act, in which *Ivy* found federal common law governed contractual disputes involving interstate telephone service, the NGA and NGPA are not so pervasive a scheme of federal regulation as to indicate a congressional objective that cannot be attained without the application of federal common law.[399]

Consequently, the court held that:

> Finding that there is no significant conflict between any federal interest and the use of state law in the interpretation of escalation provisions in gas purchase contracts, this Court holds that the appropriate contract law to apply is the law that would govern the parties' dealings were there no regulation at all of the contract's subject matter.[400]

In other words, FERC had to apply the law of the state that would apply to the resolution of contract disputes. What is significant here is that there is probably no more heavily regulated area, at the direction of Congress, than FERC's regulation of natural gas. For the court to eschew an expansive view of federal common law contractual authority by FERC strongly suggests that adjudication of QF contracts by FERC is unlikely to be sustained if judicially reviewed.

The result in *Pennzoil* is also more consistent with a judicial insight that prefers efficient outcomes. It stands to reason that, if the efficiency of the common law is a result of an evolutionary development, then the less developed federal common law of contracts is also likely to be less efficient as a whole. In particular, the judicially directed decree of specific performance of *Lincoln Mills* as the beginning point of a federal common law regarding collective bargaining contracts suggests some concern for whether the remedial rules judicially proscribed by federal common law are as efficient as those which developed over the centuries in the common law of the states.

397. FRIEDENTHAL ET AL., *supra* note 11, at 229.
398. *Pennzoil*, 645 F.2d at 385.
399. *Id.*
400. *Id.* at 387.

The differences in efficiency of various remedial choices and the distributional consequences of those choices will be examined in the next section.

V. QF CONTRACTUAL ADJUDICATION AND REMEDIAL EFFICIENCY

. . . in the case of the promises to buy electricity, the small and large producers avoided the special tribunals and instead asked the Commissions to settle their differences. The Commissions enforced some promises, denied enforcement of others, and modified others, including those it had helped develop.

The law has hierarchical preferences. Thus far we have seen that the law prefers that contractual disputes be adjudicated by state courts applying state law.[401] If the forum is a federal court, the law still prefers that contractual adjudications be decided according to the law the state court would apply.[402] The law that the state court would apply, the substantive law of contracts, contains preferences as well, particularly with respect to the remedies the court will dispense for breach of a contract.

The law of contracts of the various states provides two basic types of remedies, legal remedies and equitable remedies. Legal remedies are those developed by the common law courts and equitable remedies are those developed by courts of equity. The equitable remedies generally available for a breach of contract are injunctive relief or specific performance. Depending on the relief sought, one or the other could result in compelling actual performance of the contract. Legal remedies are substitutional. They are not concerned with actual performance but with providing the equivalent of performance in money damages. Jurisdictional conflict between the common law courts and equity courts led to a preference order of jurisdiction. That preference is for common law jurisdiction with the accompanying common law remedies. Equitable jurisdiction, with its accompanying equitable remedies, would be available only if the common law remedy was inadequate.[403] This remedial preference was maintained even after the merger of law and equity courts.[404]

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401. *See supra* Section IV.A.

402. *See supra* Section IV.B.

403. For a perspective that the courts are responsive to requests for equitable relief, notwithstanding that a remedy at law is available, see Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 HARV. L. REV. 688 (1990).

404. The vestiges of separate courts of law and equity, Chancery Courts, are still found in some states, but procedures have been developed whereby the preference for common law remedies are maintained and perhaps even dispensed by a Chancery Court,

A. *Efficiency Models and Remedial Implications*

Various legal remedies were developed by the common law for a breach of an enforceable contract. Among these there, too, was a preference. The principal legal remedies developed were expectation damages, reliance damages, and restitutionary damages. Expectation damages were preferred by the law, as that was the relief which provided the benefit of the bargain, which put the injured party in as good a position as she would have been had the contract been fulfilled, and which, in money, should make the injured party indifferent to the choice between receiving the money and having the promisor keep her promise. The law's strong preference for this remedy evolved over the years through a selection and rejection of legal rules.[405] In more recent years, when the study of economics turned its focus on legal rules, it confirmed through microeconomic analysis what the law, through its pursuit of justice, had concluded over the years: The remedy of expectation damages for breaches of contract generally leads to an efficient allocation of society's resources.[406]

An alternative statement of this finding is that expectation damages provided the appropriate incentives to encourage what has been termed an "efficient breach"[407] and discourage inefficient breaches. In other words, limiting damages to the expected benefit of the bargain will increase allocative efficiency by encouraging reallocations that will result in no party being worse off and some party being better off. Such reallocations are termed *pareto superior*.[408] In a contract situation, this opportunity to move toward greater efficiency can occur when the cost of performing the original contract is greater than the cost of substituted performance and giving the other party the expectation of the original bargain. The breaching party is better off since his contractual obligation is fulfilled at a lower cost. The injured party is no worse off since she receives the money

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as well as permitting the common law courts to dispense an equitable remedy. *See* EDGAR BODENHEIMER ET AL., AN INTRODUCTION TO THE ANGLO-AMERICAN LEGAL SYSTEM: READINGS AND CASES (2d ed. 1988).

405. George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 72 (1977):

> Efficient rules "survive" in an evolutionary sense because they are less likely to be relitigated and thus less likely to be changed, regardless of the method of decision. Inefficient rules "perish" because they are more likely to be reviewed and review implies the chance of change whatever the method of judicial decision.

Id.

406. *See* COOTER & ULEN, *supra* note 281, chs. 6, 7 & 10 (1988).

407. Lewis A. Hornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683 (1986); Robert Cooter & Melvin A. Eisenberg, *Damages for Breach of Contract*, 73 CAL. L. REV. 1434 (1985); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

408. VILFREDO PARETO, MANUAL OF POLITICAL ECONOMY (1971).

equivalent to the performance. The potential breacher is encouraged to breach because he captures the gain of the reallocation, since the remedy of expectation damages caps his liability. Similarly, granting damages in an amount no less than the expected benefit of the bargain will prevent decreases in allocative efficiency by discouraging reallocations that result in some party being made worse off. Such reallocations are termed *pareto inferior.*[409] Since the injured party will be made whole by the remedy of expectation damages, the remedy distributes the potential loss of an inefficient breach to the breaching party, thus discouraging the breach.

The Pareto criteria also are used to evaluate the allocation itself, rather than changes in allocations. An allocation is said to be at a Paretian or social optimum[410] if there is no possible reallocation that could make a party better off without making somebody worse off.[411] Thus, use of the Pareto criteria to evaluate efficiency in reallocations is rather strict[412] but effective in moving parties to a Paretian optimal allocation and keeping them there. The remedy of expectation damages assures that a party contemplating a breach of contract will ponder whether he will be the one made better or worse off as a result of his broken promise, given that his liability will be no more and no less than what he originally promised.

Pareto developed his criteria to identify desirable changes and allocations of resources that would be independent from the initial distribution of those resources and free from the difficulty of dealing with interpersonal utility comparisons.[413] It was mentioned above that the criteria were strict and, by implication, that they could be less so. The strictness in the Pareto criteria lies, as discussed above, in the implication "that full compensation must be paid whenever reallocation of resources would otherwise leave someone worse off. Without compensation, there is no way to be certain that the benefits

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409. *Id.*

410. As *The Dictionary of Modern Economics* relates:

> The term is named for Vilfredo Pareto, who first defined the social optimum, or the standard by which an economy can be judged. Although N. Kaldor, J.R. Hicks, and T. Scitovsky have attempted to refine the Paretian optimum, it still sets the conditions that maximize the economic wealth of any given society and therefore remains one of the cornerstones of welfare economics.

DOUGLAS GREENWALD & ASSOCIATES, THE MCGRAW-HILL DICTIONARY OF MODERN ECONOMICS (3d ed. 1983).

411. There may be, however, more than one Paretian optimum.

412. DAVID W. BARNES & LYNN A. STOUT, CASES AND MATERIALS ON LAW AND ECONOMICS 12 (1992).

413. *Id.*

enjoyed by the winning party outweigh the harm suffered by the loser."[414] Alternative efficiency criteria (actually a refinement of the Paretian criteria), known as the Kaldor-Hicks criteria, relaxes the requirement of actual compensation.[415] Under the Kaldor-Hicks criteria, the "reallocation is efficient if there is sufficient gain to create the *potential* for full compensation. As long as the winner gains more than the loser loses, the loser does not actually have to be paid."[416]

The Kaldor-Hicks efficiency criteria are quite utilitarian. In the interest of gaining efficiency, maximizing wealth or utility, they care little for actually compensating the loser, who bears the cost of the efficiency gain, and they care little that the winner may capture not only the efficiency gain but also keep the compensation that would, under the Pareto criteria, be transferred to the loser to make him whole.[417] In comparison, the Pareto criteria, in their implicit requirement to make the loser whole, treat the individual more fairly. However, the Pareto criteria, if insisted upon, would result in foregoing opportunities for gains in efficiency in situations where it is not possible to compensate the loser or losers for various reasons, usually because of the complexity of implementation. In contractual adjudication, the Pareto criteria for compensation carry all the problems of establishing the measure of expectation damages and effectuating a judgment. Thus the Pareto criteria are less just if one considers that they are an impediment to many efficiency-gaining reallocations where many stand to gain much and one, or a very few, stand to lose little.

The law varies in its use of these two efficiency criteria in legal reasoning. The Kaldor-Hicks efficiency criteria (or actually the notion behind them) are intuitively appealed to when the gain is to the many and the loss is to the few (i.e., class-action lawsuits), or the loss is to the many and the gain is to the few (i.e., insurance recoveries) and for some reason actual compensation or collection cannot

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414. *Id.*

415. JULES L. COLEMAN, MARKETS, MORALS AND THE LAW 95-132 (1988); R. Craswell, *Efficiency and Rational Bargaining in Contractual Settings* 15 HARV. J.L. & PUB. POL'Y 805, 806-22 (1992); ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 39-42 (1990); R. Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361, 365 (1991); A MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 7 (1989). For a critical commentary see S. Markovits, *A Constructive Critique of the Traditional Definition and Use of the Concept of "The Effect of a Choice on Allocative (Economic) Efficiency": Why the Kaldor-Hicks Test, The Coase Theorem, and Virtually All Law-and-Economics Welfare Arguments Are Wrong*, 1993 U. ILL. L. REV. 485 (1993).

416. *Id.*

417. It would appear that there is also in the Kaldor-Hicks criteria an implication that a unit of utility or wealth is valued similarly by the winner and loser, and that such value is independent of the distribution of utility or wealth.

be made. Perhaps efforts, up to a point, are even made to identify winners or losers and compensate or collect, but the Pareto criteria do not stand as an impediment. When, however, the loser is specifically identifiable, compensation can be made and, if not made, the winner will keep the gains and the value of the compensation that would otherwise be made, then our sense of justice is transgressed too much and strict adherence to the Pareto criteria appears to result in an enforced obligation of actual compensation. The Kaldor-Hicks criteria would then seem to be most justifiable in situations where the gains or losses are broadly distributed and the link between the winner's gains and the loser's losses is perhaps diffused. The Pareto criteria would seem to be less justifiably departed from in situations where the winner's gains visibly result from the loser's losses. The latter situation would seem to characterize bilateral contractual arrangements.

Applying these models to QF contracts raises interesting dilemmas. QF-utility agreements are bilateral contractual arrangements, which suggests that they should be subject to the Pareto efficiency criteria. It is possible, however, for administrative agency determinations to appear to transform the contractual arrangement to a diffuse one between the QF and the ratepayers, which suggests that the Kaldor-Hicks criteria would be appealed to in those circumstances. We will see how, in fact, rate regulatory agencies appeal to these criteria and not always in a consistent way.

Meanwhile, it is useful to remember that neither set of criteria is appropriate with respect to agency contractual adjudications. Neither is appropriate because it is not within the authority of administrative agencies to grant expectation damages. At most, agencies are given authority to award reparations, a restitutionary remedy which is unlikely to be fully compensatory in the case of partly executed contracts and which would amount to nothing in the case of executory contracts. Some agencies may be authorized to levy fines or penalties but these may be capped. They are, in any case, not flexible or precise enough to substitute for expectation damages. Therefore, one must be concerned that contractual adjudication by an administrative agency will lead to (1) bad faith in performance of the contract, (2) excessive insistence for agency adjudication of contractual differences, regardless of materiality, (3) the channeling of anything that is arguably a contract dispute into the agency for administrative resolution, and (4) most critically, inefficient adjudicatory outcomes. All this would occur because it costs less, a lot less, to breach than to perform, because the administrative agency is constrained from awarding the money equivalent of full performance. This is perfectly rational behavior by the party that would otherwise stand to lose an award of expectation damages. It is also inefficient behavior. All this should be of deep concern since administrative agencies rule over industries where contracts, such as QF-utility contracts, have significant economic impact. Granting or expanding contractual adjudicatory authority to such administrative agencies will lead to inefficient resource allocations by those regulated industries unless, of course, they also are granted authority to award expectation damages.

B. QF Contract Modifications and Efficiency Gains

As has been addressed in Section III.A of this article, the California Public Utilities Commission (CPUC) has been increasingly pressed to adjudicate contract disputes between QFs and utilities. In addition, the California Energy Commission (CEC), which had siting authority over those QFs whose generating capacity[418] brought them within the CEC's jurisdiction, had developed an "economic need test." This test required a QF applicant to "demonstrate that the cost of power from the proposed QF facility over the life of the contract will result in a total utility system cost no greater than the total utility system cost without the proposed QF facility, relying on resources readily available to the system."[419] The report added,

> The effect of this test is to require QF's [sic] to demonstrate that their projects will in fact result in "ratepayer indifference," that is, that ratepayers will pay neither more nor less than what they would have paid if the utility had been required to meet customer needs by building additional resources or purchasing power from other sources.[420]

Essentially, the CEC was requiring those QFs that required siting permits from the CEC to meet a CEC-determined avoided cost test in order to be granted the permit to construct the facility[421] — or

418. The CEC jurisdiction is over thermal powerplants 50 megawatts or greater. CAL. PUB. RES. CODE § 25500 (Deering 1993). In an effort to maximize jurisdiction, the CEC would later interpret this jurisdictional authority to mean 50 megawatts gross. This debate need not concern us here except as an indication of a concern by the CEC that some QFs were alleging their net generation to be 49.9 megawatts, with what appeared to be high parasitic losses. This debate paled in comparison to the CEC's later interest in changing the jurisdiction to 25 megawatts net in order to have the power to review more of the QF projects and their contracts.

419. PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 78.

420. *Id.*

421. Interestingly, concern never seemed to develop over whether the CEC's economic need test conflicted with PURPA and its regulations, which delegated the determination of avoided cost to the appropriate state regulatory agency (which in this case would have been the CPUC). If it had, the CEC would have looked for support in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, which held:

else come up with a good reason it did not have to meet the test.[422]

The real effect of the test, the intended one, was to force the QF to modify its contract with the utility in ways that would be more favorable to the utility.[423] In case the message had not been conveyed, the *SB 1970 Report* clarified the options to the QF. It could: (1) elect to operate under utility dispatch control or schedules, (2) negotiate different pricing terms, and/or (3) accept a delay in the

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> Congress has allowed the States to determine — as a matter of economics — whether a nuclear plant vis-a-vis a fossil fuel plant should be built. The decision of California to exercise that authority does not, in itself, constitute a basis for pre-emption . . . . [T]he legal reality remains that Congress has left sufficient authority in the States to allow the development of nuclear power to be slowed or even stopped for economic reasons.

Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n, 461 U.S. 190, 222-23 (1983).

Yet, the rather direct and express preemption of state regulation by PURPA as set forth in *FERC v. Mississippi* and the subsequent redelegation of that federal authority to the appropriate state regulatory agency, the CPUC, could have created some problems for the legal standing of the requirement that a QF must satisfy the CEC's stricter avoided cost requirement. Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742 (1982).

422. As the *SB 1970 Report* explained:

> Where an applicant narrowly misses meeting one or both of these tests, ER 6 also provided for a balancing test allowing the applicant to try to show, by clear and convincing evidence, that the project would produce other environmental or economic benefits that outweighed the applicant's failure to meet the physical and/or economic need tests.

PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 78 n.3.

423. The CEC's economic need test scheme exhibited a preference for power generated by the utility's core resources. *See id.* at 79. The same report, however, also contained an analysis comparing the total cost of electricity from recent QF and utility additions concluding that, "[i]f the cost of past resource additions (Diablo Canyon, San Onofre, SWPL) or pending resource additions (Geysers 21) are any indication, those interim SO 4 QFs that are needed compare very favorably to traditional utility resources." *Id.* at 65. The analysis is summarized in Table III-5 of that report:

Table III-5
DRA Comparison of the Average Cost of Various Resources
for the Period 1987-1995
(cents/kWh)

PG&E: QFs = 6.3	Diablo Canyon	= 12
	Geysers 21	= 10.1
SCE: QFs = 6.9	San Onofre	= 9.1
SDG&E: QFs = 5.1	Southwest PowerLink + Contracts	= 8.7

Id. Diablo Canyon and San Onofre are nuclear power plants. Geysers 21 was planned as a geothermal facility. The Southwest Powerlink + Contracts refers to purchased power. *Id.*

operational date of its plant.[424] The report acknowledged that, "Imposition of these [need] tests by the CEC has been characterized by some as 'second guessing' earlier decisions [by the CPUC] to approve interim long-run standard offer contracts." It went on to say, however, "To the extent that this characterization is correct, this result appears inevitable given the CEC's independent statutory obligation to assure that all resource additions are needed before they are approved for construction."[425]

It is interesting to note that the increasing contractual friction between QFs and utilities transformed the context of the contractual relationship. In the early 1980s, at the time the contracts were being negotiated and entered into, the contractual context was that of a bilateral relationship between QFs and utilities. To be sure, ratepayer considerations were not absent, but had been incorporated through PURPA's requirement that the electricity purchased was to be at avoided cost as determined by the appropriate rate regulatory agency. By the latter half of the 1980s, the context of the contractual relationship was that of a contract between QFs and the ratepayers, with the utilities acting as the contractual agents of the ratepayers. In effect, the avoided cost determination was being revisited, albeit indirectly, thus bringing the ratepayer to the forefront of the contractual relationship. In this new context, QF gains were seen as ratepayer losses. It is not clear that in the earlier context, had oil prices continued to increase, QF losses would have been ratepayer gains. Nor is it clear in the new context that QF gains should be ratepayer losses. After all, the utility is also acting as an agent for its investors, and investor and ratepayer interests are not necessarily congruent. Depending on the prudency of the utility's management decisions, those losses might be more appropriately distributed to the shareholders.[426]

Nevertheless, in this revised contractual context, the Joint Commission deliberated over how to reallocate gains and losses between QFs and ratepayers:

> Utilities have a difficult task when faced with requests for modification: should they accommodate the developer's request or not? Taking a tough stance on modifications may eliminate most of the weak projects, but it may also eliminate some viable and efficient projects, to the future detriment of ratepayers. A softer stance might assist viable projects, but it could also let marginal projects come on-line and increase costs for ratepayers. For these reasons, choosing the proper stance to take on contract modifications is difficult. Similarly, the utilities themselves face difficult decisions relating to when it is appropriate for them to initiate discussion of possible modifications to standard offer contracts in order to obtain ratepayer benefits without depriving a viable project of the benefits provided by its original

424. *Id.* at 79.
425. *Id.* at 79-80.
426. This will be discussed in greater detail in Section VI.B of this article.

contract.[427]

One dissenting Commissioner, critical of the majority's position above and seeking clearer language supporting contractual modifications favorable to the ratepayer, questioned whether ratepayer benefits could be obtained without depriving a QF of the benefits provided by the original contract.[428] The majority, however, explained how this could be achieved in the following manner:

> A simple example of such a situation might occur as follows: Utility A is obligated to QF B to purchase energy from its cogeneration facility for 60 mills/kWh commencing in 1990. If Utility A were able to obtain a contract for replacement energy at 25 mills/kWh (or if it could generate the energy itself for 25 mills/kWh or less), ratepayers would realize a benefit if Utility A paid QF B something less than the difference between its expected payment and the utility's cost of replacement power simply *not* to operate.[429]

The difference between the majority's report and the dissent was a different assumption about the efficiency criteria to be used in measuring the efficiency of a reallocation of resources, i.e., contractual modifications.

The majority's example assumes that the utility's proffered payment to the QF (to agree not to operate) is equal to or greater than the profits the QF would have made by operating. The profits the QF expected to make by operating are critically dependent on the cost of producing those profits or, putting it another way, the costs the QF could avoid by not operating. For example, assume that the costs the QF could avoid by not producing are 25 mills/kWh. The QF then should be indifferent about operating and making a profit of 35 mills/kWh or being paid the difference between its contract price and the cost of the replacement energy, also 35 mills/kWh. In this case, however, the utility (ratepayers) also would be indifferent because it still would cost them 60 mills/kWh either way. No party has a reason to modify the contract. However, for every additional mill above 25 mills/kWh it costs the QF to operate, the greater the possibilities that a deal can be struck such that the QF maintains the original benefit of the bargain while the utility (ratepayers) gains a benefit. For example, if the cost avoided were 35 mills/kWh, then the QF could only have expected to have made a 25 mills/kWh profit. The QF should then be receptive to any offer greater than 25 mills/kWh and less than 35 mills/kWh which would make the corresponding total cost to the utility (ratepayers) range between 50 to

427. PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 84.
428. *Id.* at 166.
429. *Id.* at 91.

60 mills/kWh respectively — less than the original total cost. The QF's cost avoided, however, would have to rise to almost 60 mills/kWh before it would be receptive to a utility offer nearing 0 mills/kWh, in which case the total utility (ratepayer) cost could be almost as low as 25 mills/kWh. If the costs the QF could avoid by not operating are less than 25 mills/kWh, then no rational QF would ever agree not to operate if the utility constraint on a proffered payment were the difference between the contract price and the replacement cost of energy, because the QF would always make more than 35 mills/kWh by operating.

The discussion of this example thus far assumes that there is some mutual gain that results in a voluntary agreement to modify the original contract. However, just as no rational QF would voluntarily agree not to operate if the proffered payment was less than its expectation interest, no rational utility would ever want to proffer more than the QF's expectation interest, because that also is the extent of the utility's liability if it chose instead to breach the contract. In other words, in the example above where the QF's cost avoided was 35 mills/kWh, even though the ratepayer would benefit by any proffered payment to the QF between 25 and 35 mills/kWh, any deal made by the utility above 25 mills/kWh would be more than the QF could recover as expectation damages if the utility did not perform. Thus, to the extent that the utility offers more than the QF's expectation interest in order for the QF not to operate, the utility is offering to the QF efficiency gains that could have accrued to the ratepayer from an efficient breach. At this point the utility's interest, i.e., investor interest, diverges from the ratepayer's interest. Consequently, at this point the regulatory question becomes the prudence of the utility's actions and whether the potential efficiency gains forgone by the utility's decision not to breach should be a cost borne by the utility's shareholders. Presumably, if the shareholders (rather than the ratepayers) bear the cost of the forgone efficiency gains, as owners of the utility they would then insist on better decision-making by the utility — or better decision-makers.

Similarly, if the utility breaches when the breach would not be an efficient one, then the cost of paying the QF expectation damages plus the cost of replacement power in excess of the original contract price would impose efficiency losses. Those losses (that is, any costs above the original contract price) would again be at issue between the ratepayers and the investing shareholders. In the example used thus far, assume that the cost of production of the QF or the cost that would be avoided by not operating is 15 mills/kWh. Then the expected profit of the QF would be 45 mills/kWh. If the utility breaches in this circumstance, the total cost of the utility's action, assuming recovery by the QF of expectation damages, would be the

45 mills/kWh plus the replacement cost of energy, 25 mills/kWh, for a total cost of 70 mills/kWh. This is 10 mills/kWh above the original contract price of 60 mills/kWh. Who should bear the cost of a decision to breach when it is inefficient to do so? Again, the interests of the shareholders and ratepayers diverge. The question of who should bear the efficiency loss occasioned by an inefficient breach then becomes a regulatory question of the prudency of the decision to breach. Again, depending on the regulatory determination of the prudency of the decision to breach, the issue could become one between the utility's management and its shareholders.

The issue of prudency will be taken up later. What concerns us for the moment, however, is not to lose sight of the basic assumption in the Commission's simple example. That assumption was the incorporation of the Pareto efficiency model in assessing the acceptability of contractual modifications between QFs and utilities. The statement that a QF and utility could change their contractual arrangement to the benefit of ratepayers without reducing the overall benefits provided the QF under the standard offer contract is the essence of the Pareto efficiency model.

However, the dissenting Commissioner's view is more consistent with the application of the Kaldor-Hicks efficiency criteria in which actual compensation to the QF need not be made or, if compensation is made, it need not be full compensation. Recall that the Kaldor-Hicks efficiency criteria only required the *potential* for full compensation. As long as the benefits to the utility, presumably passed on to the ratepayers, are greater than the losses to the QF, a breach is efficient and need not be deterred by requiring actual compensation to the QF. Under the Kaldor-Hicks criteria, the QF's loss is a necessary sacrifice for the greater good. Indeed, even the majority's simple example, standing alone absent the assistance of the intent provided in the body of the text (to which the simple example is an explanatory footnote) does not insist on full compensation to the QF. It states that ratepayers would realize a benefit if Utility A paid QF B *something* less than the difference between its expected payment and the utility's cost of replacement power. In its ambiguity,[430] the example itself might be taken to illustrate the appropriateness of applying the Kaldor-Hicks efficiency criteria to contractual

430. This technical ambiguity between what the text intended (the Pareto model) and what the explanatory example permits (the Kaldor-Hicks model) is a good illustration of the indeterminateness of the basis of regulatory decision-making in the case of QF-utility contractual adjudications by administrative agencies.

modifications between the QF and the utility, acting presumably on behalf of the ratepayers. Unqualified as it is, and with no requirement for full compensation, the example could be taken to mean that it could be *anything* less than 35 mills/kWh down to 0 mills/kWh. This view evinces a concern solely for the efficiency gain of the reallocation and dispenses with the necessity of full compensation to the QF. Although justifiable from an efficiency perspective, it seems unlikely that in such a reallocation the QF would not be compensated at all. What seems more likely is that it would be undercompensated.

The compensation that could be proffered to the QF, as the simple example indicates, would lie in a continuum between the cost of replacement energy and the original contract price. However, the compensation likely to be offered is one of three compensation levels in between. The QF might receive an offer based on the utility's assessment that the QF is certain to recover expectation damages in a court of law. In this case, the QF probably would be offered its expectation damages, less the utility's assessment of the QF's cost to recover those damages. Another possible offer is one based on the utility's assessment of the QF's probability of recovering expectation damages in a court of law. In this instance, the QF would probably be offered the utility's assessment of the expected value of the court judgment less the utility's assessment of the QF's cost to recover those damages. The third possible offer of compensation is one based on the utility's certainty that the QF will not recover expectation damages in a court of law. In this instance, the offer to the QF will be the same offer that would be made for the replacement energy. This is the level of compensation at which the utility would be indifferent about whether the purchased power came from the QF or any other source. Whether the QF would accept these offers would depend on the extent to which the QF's own assessment of litigation outcomes and recovery costs is congruent with the utility's assessment.[431]

431. As Barnes and Stout explain:

> The prevalence of pre-trial settlement is another example of the Coase Theorem and the power of voluntary exchange. Because a trial requires both parties to invest substantial sums in attorney's fees that cannot be recovered, there is usually a range of settlement amounts that both parties perceive would leave them better off than if the case were litigated to the bitter end. Under such circumstances rational parties will settle.

BARNES & STOUT, *supra* note 412, at 292. The Coase Theorem in its more generally accepted interpretation states that as long as there are no obstacles to transactions between affected parties, the resources will be allocated efficiently regardless of how property rights are initially assigned. *Id.* at 49. Also, "[L]itigation is likely to occur chiefly when the parties disagree over what the court will find the efficient outcome to be." George L. Priest, *Selective Characteristics of Litigation*, 9 J. LEGAL STUD. 399, 410 (1980); *see also*, George L. Priest & Benjamin Klein, *The Selection of Disputes for*

The problem with the utility undertaking offers at the first level of compensation is that, since the utility is persuaded that the QF would recover expectation damages in a court of law, it may not be worth the effort to seek modifications. Such efforts would entail costs to the utility that may offset the gains to be made. It also would be an obvious exercise of bad faith that could result in other repercussions, perhaps cost-related (such as reimbursement disallowance of litigation expenses), in this regulated environment. The problem with the utility undertaking offers at the second level of compensation is the difficulty of ascertaining the necessary probabilities as well as the computation of expectation damages in order to arrive at an expected value.

Almost by default, the third possible level of proffered compensation is left as the most viable. It is not, however, without its inherent appealing aspects. First, this level has quantitative certainty because it has an external benchmark, the cost of replacement energy. Second, this level of compensation, the lowest level, has political appeal since the utility can hide behind the ratepayer's tariffs. The utility will overlay the QF-utility contractual interface with the utility-ratepayer tariff interface and transform it into a QF-ratepayer matter. Third, it has an implicit economic appeal. Assuming that the offer of replacement energy at the lower cost is real, then the obvious question posed is why the costs avoided by the QF for not producing are impliedly higher than they are for the producer of the replacement energy.[432] In competitive equilibrium they should be the same.[433] Whether or not that question has a good answer (noting that there have been and continue to be impediments to achieving

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Litigation, 13 J. LEGAL STUD. 1 (1984).

432. We are still assuming the conditions for an efficient breach. In our example, if the costs to be avoided by the QF were equal to or less than the costs avoided by the replacement energy producer (25 mills/kWh or less), the breach would not be efficient. This also assumes the replacement energy producer is pricing his energy at or above the cost he would avoid by not producing. In the case of a third party this means that the sale is not resulting in any losses. In the case of the utility, this means that it is not using monopoly rents to subsidize production losses at the margin in order to price competitors out of business.

433. This explains, in part, the rapid development of bidding schemes for marginal acquisitions of capacity and energy. *See* PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 135; California Pub. Util. Comm'n, Order to Implement Biennial Resource Plan Update & Order Instituting Investigation to Develop a Policy on Nondiscriminatory Access to Electricity Transmission Service for Nonutility Power Producers, Dec. No. 93-06-099, 1993 Cal. PUC LEXIS 356 (1993); FERREY, *supra* note 17; Regulations Governing Bidding Programs, 53 Fed. Reg. 9324 (1988); IV F.E.R.C. Stats. & Regs. 32,455 (1988) [hereinafter Bidding NOPR].

competitive equilibrium in the electricity market, and despite the fact that PURPA, its legislative history, and FERC regulations recognize that QFs may have higher costs than competitive equilibrium would suggest and might have to be paid correspondingly more for their electricity to achieve the purposes of PURPA),[434] a second question arises: Why should investors or ratepayers pay the difference if they don't have to, particularly if not paying the difference may be more economically efficient (in the world defined by the triad of QFs, utilities, and ratepayers) than paying it? After all, all that stands in the way of achieving the efficiency gains is a modification of a promise through which the QF is given slightly more than it economically deserves, in the view of the utility and ratepayers, though it is not given what it was promised. The Kaldor-Hicks efficiency criteria provides both the answer, "You don't have to!" and the exculpation for the broken promise, "Efficiency!"

Understandably, the Kaldor-Hicks model is quite appealing in this regulatory setting, to all except, perhaps, the QF, for several reasons. First, since the administrative agency does not have the authority to award expectation damages, the Pareto efficiency model cannot be implemented by the agency. However, since the Kaldor-Hicks efficiency model dispenses with the constraint of having to make the losers whole through expectation damages, the administrative agency is not foreclosed, simply by the absence of that authority, from playing a role in the reallocation of resources if it can devise such a role through other remedial opportunities. Second, by overlaying the QF-utility contractual interface with the utility-ratepayer interface, the administrative agency has reframed the distributive consequences of the Kaldor-Hicks reallocation from one that would be considered unfair by some to one that conforms with the administrative agency's role of regulating in the public interest. In other words, even though the Kaldor-Hicks model would justify (on the basis of efficiency) a breach that would produce more gain to the utility than loss to the QF, there is an intuitive sense of unfairness about such a reallocation. However, if a reallocation has the potential of producing more gain than loss to the QF, but the gain is broadly distributed among the ratepayers, not only is the unfairness attenuated, but the case for the reallocation would appear to be compelled by the goal of regulating in the public interest, assuming the public interest is the same as

434. *See* 18 C.F.R. § 292.304(b)(5) (1993):

> In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

Id.

the ratepayer interest.[435] Finally, the Kaldor-Hicks model is appealing because it avoids the difficulties of actually computing expectation damages, although it, too, requires some sense of what they are in order to determine whether the reallocation is efficient. While the concept of expectation damages is clear, the actual measurement is often difficult. The expectation damages in QF-utility contracts would be additionally difficult to measure because of the difficulty in ascertaining the costs avoided by the QF and the expected revenue stream during the life of the contract. Although some contracts contain levelized payments for a fixed period of years, even those revert to actual avoided costs after that period. It is clear that there would be damages sustained, but ascertaining the damages for purposes of a remedy might be a difficult proposition. Therefore, the Kaldor-Hicks model permits a reallocation notwithstanding the uncertainty of what the expectation damages may be; this uncertainty would not be as easily tolerated by the Pareto model. A proposed reallocation is likely to be administratively permitted with a regulatory "sense" that there are probably more gains than losses. A corollary consequence is that, given the uncertainty of the expectation damages, the "justness" of the proposed reallocation will be measured by the extent of the deviation from that which is actually known, the cost of replacement energy.

C. *Distributional Consequences of Remedial Choices*

In this regulatory setting, the Kaldor-Hicks efficiency model, with its toleration of non-compensation to the losers, can result in some perverse behavior. There are incentives for collusion between the utility and ratepayers to extract gains from the QF's expectation interest. There are also incentives for collusion between the QF and the utility to capture the efficiency gains that otherwise might accrue to the ratepayer. Collusion opportunities between the QFs and the ratepayers to extract gains from or transfer losses to the utility are limited by a regulatory scheme operating under the constitutional constraint that a utility needs to be allowed a rate of return sufficient

435. PURPA, its legislative history and implementing regulations (in particular the rule permitting avoided costs payments higher than actual avoided costs), and the implementation of PURPA by various states with avoided costs higher than actual avoided costs, suggest that the public interest purpose of PURPA is broader than the ratepayer interest. *See* 18 C.F.R. § 304(b)(5) (1993). However, in agency-speak "the public interest" often means nothing more than "the ratepayer interest."

to attract capital.[436]

For example, the utility and the ratepayers could collude to divide the sum of the efficiency gains plus the value of the uncompensated QF losses. Returning to our simple example, assume that the QF's cost avoided by not performing is 35 mills/kWh. The QF's expectation damages would be 25 mills/kWh. Under Pareto criteria, if the utility breached, it would have to compensate the QF for those expectation damages of 25 mills/kWh and purchase the replacement energy at 25 mills/kWh. The total cost of the reallocation is now 50 mills/kWh, for an efficiency gain of 10 mills/kWh. The division of those gains is now an issue between the utility and its ratepayers. Under the Kaldor-Hicks efficiency criteria, everything would be the same except that actual compensation of expectation damages need not be made to the QF. The incentive now is for the utility and ratepayers to collude, pay the QF less than full compensation, and then divide the amount by which the QF is undercompensated. For example, the utility and ratepayers could collude to limit compensation to the QF to 5 mills/kWh. Adding this to the cost of replacement energy (25 mills/kWh) results in a reallocated total cost of 30 mills/kWh, thus making available 30 mills/kWh for division between the utility and the ratepayers.

The above scenario, although possible, is unlikely because it constitutes such gross bad faith and injury to the QF that it would likely

436. *See* Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1943). It could be argued that the manner in which this constitutional command (which avoids a "taking" of the utility's property) has been implemented by rate regulatory agencies also operates as an upper bound on its opportunities for gains. Thus, the utility is prevented by the regulatory scheme from capturing any gains and is forced to transfer any benefits above its allowed rate of return to the ratepayers. This is, however, a more complex matter that is not necessary to pursue fully for our purposes of the moment. It is sufficient to note that the utility is not necessarily as indifferent as the above argument might suggest to the attempted capture of the QF's expectation interest or retention of gains that would otherwise go to the ratepayers. It could have an interest in these monies if it wished to *assure* that it made its allowed rate of return. It also could have an interest if it is operating, for whatever reason, under a revenue-maximizing mode rather than a profit-maximizing mode. Such monies could simply allow the utility to relax its vigilance over its own efficiency.

A vivid case in point was provided recently when the Division of Ratepayer Advocates (DRA) of the CPUC alleged that Southern California Edison (SCE) had, among other things, failed to take advantage of contract terms which gave SCE the ability to cancel or negotiate downward the pricing terms of contracts with a number of QFs. DRA's advocacy resulted in a CPUC decision involving one QF which disallowed approximately $50 million of ratepayer reimbursement to SCE (Dec. 90-09-088). In the meantime, DRA continued to press the matter with respect to other QF contracts involving the same utility. All this led to a Settlement Agreement between SCE and DRA estimated to have a value of $250 million that will be passed on to the ratepayers in reduced rates over the life of the QF contracts. See In the Matter of the Application of the Southern California Edison Company (U 338-E) for: [Among other matters] Review of the Reasonableness of Edison Payments to Qualifying Facilities Under Nonstandard Contracts etc., Decision No. 93-03-021, 1993 Cal. PUC LEXIS 161 (1993).

be provoked to seek relief before the courts. In that case, the utility and the ratepayers would face the prospect of not only losing the captured undercompensation but also having litigation costs erode the efficiency gains they would have realized had they paid expectation damages to the QF up front. What is more likely is that the utility and ratepayers would collude to insist on contractual modifications or settlements that result in undercompensating the QF as much as possible, but not beyond the point of provocation that would drive the QF to a court of law to seek expectation damages. In essence the ratepayers and the utility would collude to capture as much of the QF's expectation damages, i.e., the expected profits, up to the point where the QF's investors' rate of return becomes unacceptable. For example, the utility and the ratepayers could collude to force a modification of the contract price from 60 mills/kWh to 50 mills/kWh. This is 15 mills/kWh above the cost that would be avoided by the QF if it did not produce electricity. Assuming that the 10 mill/kWh reduction from the originally expected 25 mills/kWh still leaves an acceptable return of 15 mills/kWh to the QF's investors, then the utility and ratepayers have 10 mills/kWh to divide between them. This 10 mill/kWh does not come from an efficiency gain, although from the benefit perspective of the utility and ratepayers it appears indistinguishable from the 10 mills/kWh that resulted from the efficient breach. In fact, it comes solely from undercompensation to the QF and in this circumstance there are no efficiency gains. The efficiency gains in our example come from shifting production to the lower-cost producer. In this instance, the higher-cost producer, the QF, is still in business. The benefits came directly from the QF's expected profits.

From the narrow perspective of the utility and the ratepayers, both would be indifferent whether their 10 mill/kWh comes from the QF's expected profits or efficiency gains. From a broader perspective, they should not be indifferent. The gain that may come from a contractual modification may mask the opportunities that exist for greater gains. For example, if the QF is willing to accept a contractual modification that results in its receiving 50 mills/kWh, then it should be indifferent between operating and making 15 mills/kWh and not operating and being paid 15 mills/kWh, in other words, being paid a buyout at less than the QF's contracted expectations. Adding the replacement cost of energy of 25 mills/kWh makes the total reallocated cost equal 40 mills/kWh, resulting in 20 mills/

kWh, the difference between the original contract price and the reallocated total cost, available for distribution between the utility and the ratepayers. The 10 mills/kWh of efficiency have been regained.

Why, then, would the utility and ratepayer alliance, if strong enough to force a modification of the original contract price, stop at that and not pursue the efficiency gain? There are several reasons. First, there is a political constraint. In its review of the QF-utility contracts in California, the Joint CEC-CPUC Commission concluded, "we must discourage at this time the idea of buyouts. If the utilities have compelling reasons for a buyout, with overwhelming benefits for ratepayers, they can come to the CPUC with an application for prospective approval."[437] The combination of "compelling reasons," "overwhelming benefits to ratepayers," and "prospective approval" effectively closed the door to shutting down the less efficient producer, the QF. Second, the QF may not be willing to accept anything less than its expectation interest. The Joint Commission expressed that view when it stated that, "On the other hand, the projects that make attractive candidates — i.e., projects making some progress toward completion — may not find a buyout as attractive as operating, or may be too expensive to buy out."[438] In our example in which the QF's cost avoided by not producing is 35 mills/kWh, there would be ratepayer benefits if the QF were to be bought out at any price less than 35 mills/kWh. However, there is no reason the QF would want to accept less than 25 mills/kWh and there is no reason why the ratepayers should want to offer more. Therefore, there is no deal. Third, the QF may not be the less efficient producer. The Joint Commission's language above, that a QF may not find a buyout as attractive as operating or may be too expensive to buy out, also accommodates the possibility that the QF's cost avoided by not operating is *less* than the replacement cost of energy. For example, in our continuing example, if the QF's cost avoided by not operating is 20 mills/kWh, its expectation interest is 40 mills/kWh. The QF would not agree to a buyout for less than 40 mills/kWh, which means that not only would the buyout be "too expensive" in that it would cost more than expectation damages, but it also would be "too expensive" in that it would be an inefficient reallocation that would impose costs on the ratepayer. In this instance, the cost of the buyout, greater than 40 mills/kWh, would be added to the 25 mills/kWh cost of replacement energy to produce a reallocated total cost equal to or greater than 65 mills/kWh. Everything above the 60 mills/kWh would be inefficiency losses incurred from buying out the lower cost producer, the QF, that would more

437. PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 111.
438. *Id.* at 110.

than likely be passed on to the ratepayer as a reimbursement to the utility. Fourth, there may be uncertainty about whether the replacement cost of energy really will be available at 25 mills/kWh. The replacement cost of energy in our continuing example has up to this point been taken as a certain option. In actuality, it would be a prediction with inherent uncertainty about its realization. The prediction is derived from rather complicated resource planning models. Models are simply that, approximations of the real world, and the independent variable inputs bring their own uncertainty to the mix. Regarding the uncertainty inherent in the output of such models, including the replacement cost of energy, which led the Joint Commission to regard buyouts unfavorably, the Joint Commission stated, "In addition, the value of a buyout depends on a forecast of demand and supply conditions for the life of the bought-out contract."[439] The demand and supply conditions will determine the replacement cost of energy. Finally, if the replacement energy option is utility-generated electricity, it may be an economically rational move to keep the QF in business, even if it may be a higher-cost producer. The QF-utility contractual arrangement transfers risk, which eventually translates to a cost, away from the utility and the ratepayers to the QF. The risk of capital, the risk of regulatory changes, and risk in general are transferred to the QF's investors.[440]

Collusion also could occur between the utility and the QF. Using our continuing example in which the cost avoided by the QF by not producing is 35 mills/kWh and the contract price is 60 mills/kWh, the QF's expectation damages would be 25 mills/kWh. The utility could offer the QF 27.5 mills/kWh as a "settlement," skim 2.5 mills/kWh on the deal, and the reallocation still would be efficient since the total cost resulting from the reallocation is only 55 mills/kWh. Presumably, the remaining 5 mills/kWh would be passed on to the ratepayers to mask the collusion. It is unlikely that a utility

439. *Id.* at 111.

440. A. Lawrence Kolbe & William B. Tye, *The Duquesne Opinion: How Much "Hope" is There for Investors in Regulated Firms*, 8 YALE J. ON REG. 113, 155-57 (1991) ("[R]egulators and investors may attempt to impose contractual limitations on regulatory discretion to change the rules. For the electric utility industry, this is essentially the path of cogeneration and power production contracts."); Edward P. Kahn, *Risks in Independent Power Contracts: An Empirical Survey*, ELEC. J., Nov. 1991, at 30; Mason Willrich & Walter L. Campbell, *Risk Allocation in Independent Power Supply Contracts*, ELEC. J., Mar. 1992, at 54; Bernard S. Black & Richard J. Pierce Jr., *The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry*, 93 COLUM. L. REV. 1339, 1349 (1993) (Power producers are bearing many risks formerly borne by consumers.).

would or could knowingly operate in this manner. It does, however, dramatize the opportunities that are encouraged by the Kaldor-Hicks model operating in a regulatory setting. It is more likely that the utility may be too risk averse or not vigilant enough to fully capture the efficiency opportunities. Consequently, if the utility's risk averseness exaggerates what a QF is likely to recover as expectation damages, or whether it is likely to recover at all, by not pursuing litigation the utility is foregoing efficiency gains that otherwise would be passed on to the ratepayers. In other words, though it is not likely to skim 2.5 mills/kWh, it is more likely that it might offer the QF 30 mills/kWh in order to achieve a 5 mills/kWh efficiency gain. In essence, the risk averseness of the utility is being transferred as a cost, the efficiency gains foregone, to the ratepayer. It is a ratepayer cost because the ratepayer reimburses the utility for the entire cost of the settlement, including the amount above the more limited expectation damages that the QF could have recovered in a court of law. The ratepayer's own vigilance may be relaxed by the fact that the QF and the utility would in their "settlement" allow a portion of the efficiency gains to trickle down to the ratepayer. The QF in this arrangement gains more than if it had operated, the utility buys out a competitor with ratepayer funds, and all at a greater cost to the ratepayers than if the ratepayers' champion, the utility, had duked it out in court and *lost*.

Into this mix of players, shifting alliances and confounding incentives, we add the choice of the administrative tribunal for resolution of contract disputes and address more directly the comparative distributional considerations of the distinct remedies sought from each. Quite clearly, the remedial preference of the courts for the Pareto model (that is, to make the loser whole in an efficient breach by awarding her the expectation interest), the unavailability of that remedy to the administrative tribunal, and the preference of the administrative tribunal for the flexibility of the Kaldor-Hicks model creates incentives for forum shopping.

The utilities and the utility-ratepayer alliance have an economic interest in resolving contractual disputes before the administrative agency rather than before the courts. The downside risk of losing and having to pay expectation damages is eliminated. There also is an upside opportunity that they can capture some of the QF's expectation interest by persuading the administrative agency to undercompensate the QF. Indeed, the Commission recognized this in a recent contract dispute in which it was asked by the utility to modify a previous decision in an effort to affect resolution of the contractual dispute. The Commission said, "The Petition for Modification . . . provides [the utility] with an opportunity to improve its position in the dispute with little risk of loss."[441]

The QF-utility alliance also has an economic interest in resolving contractual disputes before the administrative agency. Such resolutions may not be without the trickle-down benefits to the ratepayers discussed above but the principle beneficiaries are the QF and the utility. The QF eliminates the possibility of losing before the court of law and receiving nothing, or it may have been offered, as discussed above, a settlement above what its expectation damages would have been had it won before the court of law. The utility has the same economic interests discussed above in resolving the dispute before the administrative agency. However, through a settlement proposal before the administrative agency it now gains the assurance of ratepayer reimbursement, which it would not necessarily have received before a court of law. As discussed above, this assurance can come at the expense of the ratepayer if the utility's risk averseness results in a settlement in which the QF receives more than it would have received before the court. In other words, this would be all of the settlement amount if the QF would have lost or any settlement amount in excess of expectation damages if the QF had won. The QF is thus assured of payment and the utility is assured that the ratepayer will reimburse the utility.[442] This, too, has been recognized by the Commission:

> Often, utilities and QFs will settle contractual disputes by modifying their agreements. When the utility presents such contract modifications to the Commission for its approval, it is for the purpose of assuring that costs stemming from the revised contract will be passed through in rates. In making that determination, the Commission normally considers the merits of the underlying contract dispute to assess the extent to which the settlement reflects the risks that would have been borne by each party had the dispute been litigated.[443]

With respect to the QF's forum choice, although it would at first appear that the QF's economic interest is better served by the possibility of expectation damages before a court of law, such is not the case. Interestingly, QFs have turned to the courts far less than might be suggested by the availability of expectation damages as the equivalent of utility performance or even, merely, as a bargaining threat. There are several reasons for this. First, a court of law's determination would more than likely be an all-or-nothing result and

441. Transmission System Operation: Midset, *supra* note 81, at 8.

442. Evidence of the strength of the QF-utility allied interests is that ex parte approval was usually sought. In other words, Commission approval was sought absent the scrutiny of the normal hearing process.

443. Transmission System Operation: Midset, *supra* note 81, at 6.

the QF may be too risk averse to pursue that option. Second, the QF may have confidence that it can bolster a weak legal case by political prowess[444] exercised through access provided by the more informal

444. An interesting example is provided in a recent FERC decision, Kramer Junction Co., 61 F.E.R.C. ¶ 61,309 (1992). In this decision, at the collective request of what appears to be three financially related solar electric generators, FERC granted a waiver from its own regulations regarding fossil fuel limitations applicable to qualifying small power production facilities that restrict the use of fossil fuel to no more than 25% of the total energy input during any calendar year. These solar QFs relied on natural gas combustion for various reasons but otherwise apparently observed FERC's fossil fuel limitations. The basis for the waiver was the necessity "to alleviate the financial effects of a sharp reduction in solar-powered electrical generation allegedly attributable to climatic changes resulting from a particular volcanic eruption." *Id.* The QFs, located in Southern California, claimed that, but for the "lingering atmospheric effects from the June 1991 eruption of Mt. Pinatubo in the Phillippines" approximately a year earlier, they would have been able to generate the equivalent amount of revenues that the waiver request would allow them to recoup. *Id.* The QFs argued that, absent the waiver, they faced financial ruin. They therefore sought expedited action from FERC.

The utility obligated to purchase the QFs' power filed a protest and a motion to intervene. It stated that "no direct relationship has been established between the Mt. Pinatubo eruption, any reductions in sunlight, and the reduced ability of the solar facilities to produce solar-powered energy." *Id.* The utility pointed out that the Gulf War oil fires also could be likely causes of reduced sunlight, and that even if Mt. Pinatubo was the cause it was a voluntarily assumed foreseeable risk since 10 volcanic eruptions had occurred since 1980. It argued, that, in any case, under the terms of the contract, each party had agreed to assume year-to-year fluctuations in solar radiation and to live with the associated risk. Finally, the utility argued that the QFs' appropriate remedy was invocation of the force majeure clause of the contract and that if the appropriateness of such invocation was in question, resolution of the dispute was a matter for the state courts. The utility calculated that the waiver would essentially constitute an $8,000,000 subsidy at the expense of its ratepayers.

FERC granted the waiver, noting that it had "never faced this precise issue" but that it was a "close one" and, in its judgment, "the unanticipated drop in solar radiation is beyond normal business risks." *Id.* It also noted filings of letters of support for the QFs' waiver from the Department of Energy and the California Energy Commission.

A separate concurring opinion by one Commissioner stated that:

> Without corroborative evidence that would allow me to conclude that the eruption of Mount Pinatubo was the sole or even primary cause of the decline in direct solar radiation, I am not convinced that the situation at hand falls outside the levels of risk that Kramer and Southern California Edison Company (Edison) have agreed to assume under their contract. However, this is a contractual matter more suited to state court than the Commission.

Id. (Terzic, Comm'r, concurring). The Commissioner's concurrence indicated that the support of the California Energy Commission was of significance to him and, in a comment worthy of Sherlock Holmes' observation of the curious incident of the dog during the night (that it did not bark), he also found it significant that the California Public Utilities Commission did not intervene in or protest the $8,000,000 ratepayer subsidy.

These QFs appear to be related as well to Luz Solar Partners Ltd., which in 1985 received an Order Conditionally Granting Certification as a Small Power Production Facility when the issue appeared to be whether the intended use of natural gas was permissible under PURPA. In that decision, Luz Solar Partners Ltd., 30 F.E.R.C. ¶ 61,122 (1985), FERC noted that the application had drawn letters urging expedited action from then-U.S. Senators Alan Cranston and Pete Wilson of California and U.S. Senator James McClure of Idaho. Other letters of support were received from the Chairman of the California Energy Commission and the Israeli Minister of Economic Affairs. The U.S. Secretary of Energy at the time, Donald Hodel, also encouraged FERC's early resolution of the application.

processes of an administrative agency and weak ex parte contact rules, if any.[445] Third, there may be difficulties in ascertaining the measure of damages, perhaps leading to concerns that the legal remedy would not be fully compensatory.[446] A fourth and final reason is that the QF may feel entitled to the equitable remedy of specific performance and may believe it is more likely to receive it from the administrative agency. This last reason may have moral and economic dimensions.

Returning to our continuing example, recall that the contract price was 60 mills/kWh, the replacement cost of energy was 25 mills/kWh, and the QF's cost avoided by not producing was 35 mills/kWh, resulting in a QF expectation interest of 25 mills/kWh. It would be efficient if the utility breached its contract with the QF, paid the QF its expectation interest, and contracted with the producer of the replacement energy, resulting in a reallocation with a total cost of 50 mills/kWh. The efficiency gain of 10 mills/kWh would accrue to the breaching party.[447] This efficient breach result has been compared to an "efficient theft" or "efficient conversion."[448]

A later application for similar relief, on the same grounds as *Kramer Junction*, by solar-powered facilities originally built by the same developer and facing the same operational and financial difficulties, Daggett Leasing Corp., 64 F.E.R.C. ¶ 61,148 (1993), met greater resistance. This time the CPUC did protest and intervene, nevertheless, the application was granted. This time the owners produced letters of support from the Department of Energy, Senator Boxer, and Representatives Jerry Lewis, George Brown, and Richard Lehman. Commissioner Santa filed an extensive critical dissent.

445. The California Public Utilities Commission, for example, did not have any rules on ex parte contacts until recently. *See* Rulemaking, Dec. No. 91-10-049, 127 P.U.R. 4th 184 (1991). Even if an agency has such rules, they would more than likely apply only to "adjudications," that is a proceeding initiated in this instance by a complaint. As was mentioned in Section III.A, quite often the contract disputes are framed in the context of an application or petition for modification, which may not be technically considered "adjudications."

446. *See* Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443 (1980).

447. It might be passed on to the ratepayers, but this need not concern us for now.

448. Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989):

> To see the point, observe how this account of efficiency plays out in two cases. In the first, A promises to sell a machine to B for $10,000 but then turns around and sells it instead to C for $18,000. In the second, B owns a machine for which he has paid $10,000, which A takes and sells to C for $18,000. To keep matters simple, assume that B values the machine at exactly $12,000 in both cases. If the willful contract breach is justified in the first case, then the willful conversion is justified in the second. In the first, B gets $2,000 in expectation damages and is released from paying the $10,000 purchase price. In the second, B obtains damages for conversion equal to $12,000 because he has already paid the $10,000 purchase price to his seller. The two cases look identical even though they derive from distinct substantive fields.

This perspective sees the performance owed the QF by the utility as a right or entitlement created by the utility's promise and which the utility has a moral obligation to perform unless excused by the QF. Kant, Hume, the "mature John Rawls," Hannah Arendt, and God's example have been invoked in support of this view.[449] Not surprisingly, such a moral perspective would lead, and in fact does according to one scholar,[450] to a preferred remedy of specific performance. Therefore, in seeking specific performance, the QF would be aligned with a "moral consensus"[451] reflected in the positive law.

With respect to discerning the economic interest of QFs in specific performance, we begin with the logical conclusion that if expectation damages are the substituted equivalent of specific performance (assuming for the moment that expectation damages are fully compensatory), then they should be equally efficient remedies (also assuming for the moment that transaction costs are zero and that a cover market exists).[452] There is, however, a difference in the distributional effect of the two remedies that would lead the QF to prefer specific performance. In the case of an efficient breach, the choice of specific performance awards the efficiency gains to the QF. However, the choice of expectation damages awards the efficiency gains to the utility. In our continuing example, the remedy of expectation damages results in making the QF whole, but the efficiency gains are captured by the utility. If the QF were awarded specific performance, then the QF, under the assumptions noted above, would be able to cease its production of electricity, purchase replacement energy at 25 mills/kWh, sell it to the utility at the contract price and

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Id. at 4.

449. For a broad summary of the moral arguments see DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE 255-59 (1991).

450. Laycock's review of 1,400 cases involving the choice between a remedy at law and specific performance leads him to conclude that the state of the positive law is that "[c]ourts do not limit remedies so that promised resources can be reallocated to their most valued use, and courts do not recognize a general right to breach and pay damages. Whenever anything important depends on the choice of remedy, courts protect plaintiff's entitlement to the specific thing he was promised." *Id.* at 260.

451. *Id.* at 256. Judge Posner, in a different context, considered what value specific performance would have to a similarly situated utility supplier of coal. He stated: "Probably, therefore, Carbon County is seeking specific performance in order to have bargaining leverage with NIPSCO [Northern Indiana Public Service Company], and we can think of no reason why the law should give it such leverage." Public Serv. Co. v. Northern Indiana Carbon Coal Co., 799 F.2d 265, 279-80 (7th Cir. 1986).

452. For the consequences to this conclusion if these assumptions are changed, there are several highly readable sources, incorporating reviews of the literature, concerning the debate over the relative efficiency, and other merits of the remedies of expectation damages and specific performance which can be consulted. *See, e.g.*, Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683 (1986); COOTER & ULEN, *supra* note 281; EDWARD YORIO, CONTRACT ENFORCEMENT: SPECIFIC ENFORCEMENT AND INJUNCTIONS (1989); LAYCOCK, *supra* note 449.

capture the efficiency gain of 10 mills/kWh as well as expectation damages of 25 mills/kWh for a total of 35 mills/kWh.

If we now allow for the existence of positive transaction costs,[453] circumstances may result in which the QF would be amenable to selling the utility its entitlement to specific performance. However, the rational QF certainly would demand more than its expectation damages and would demand a price greater than the difference between its entitlement and the transaction cost of purchasing the replacement energy. For example, assume that the transaction cost of the QF's purchase of electricity from the replacement energy provider is greater, say 2 mills/kWh, than the transaction cost of negotiating a buyout with the utility, say 1 mill/kWh. Then it would be more profitable, both for the QF and the utility, to negotiate a buyout of the QF's right to specific performance. In this example, the QF and the utility should be able to come to an agreement at 34 mills/kWh. The utility's total cost of the buyout and replacement energy would now total 59 mills/kWh. The utility would get 1 mill/kWh of the efficiency gain and the QF would get 9 mills/kWh of the

453. It is possible that relaxing this constraint may affect the relative efficiency of the remedies of expectation damages and specific performance. For our illustrative purposes of the major consequences of the shift of the entitlement of the efficiency gain, this need not raise any major impediments in considering the illustration. The debate over the relative efficiency of these remedies is detailed, complex and unsettled. *See, e.g.*, Robert L. Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49 (1969); Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970); John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277 (1972); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (1973); Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978); Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979); Diamond & Maskin, *An Economic Analysis of Search and Breach of Contract I: Steady States*, 10 BELL J. ECON. 282 (1979); Steven Shavell, *Damage Measures of Breach of Contract*, 11 BELL J. ECON. 460 (1980); Diamond & Maskin, *An Economic Analysis of Search and Breach of Contract II: A Non-Steady State Example*, 25 J. ECON. THEORY 165 (1981); Peter Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity and the Second Restatement*, 81 COLUM. L. REV. 111 (1981); Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365 (1982); Ian R. MacNeil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982); Timothy J. Muris, Comment, *The Costs of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053; Steven Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q.J. ECON. 121 (1984); Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341 (1984); William Bishop, *The Choice of Remedy for Breach of Contract*, 14 J. LEGAL STUD. 299 (1985); Ian R. MacNeil, *Contract Remedies: A Need for Better Efficiency Analysis*, 144 J. INST'L & THEORETICAL ECON. 6 (1988); Richard B. Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 SO. CAL. L. REV. 629 (1988); Daniel Friedman, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989).

efficiency gain plus its expectation damages.

In the real world there are transaction costs, perhaps indeterminate until they are incurred, so there should be no unrealistic expectations that contract dispute resolutions will follow textbook examples. After all, there are other complicating factors besides economic considerations.[454] However, we are speaking for the most part about a general analysis that could explain QF and utility behavior in seeking resolution of their contractual disputes. It seems reasonable to conclude that the economic analysis above supports a conclusion that the battle between QFs and utilities is a battle over entitlement to the efficiency gains in the efficient breach opportunities that were created by the tremendous drop in oil and alternative fuel prices. The utilities prefer the CPUC as a forum because at worst they can minimize downside risks by avoiding expectation damages while at best they can maximize opportunities to capture not only the efficiency gains but perhaps some of the QF's expectation interests. The QFs prefer the CPUC as a forum because at best they maximize the opportunity of obtaining the entitlement of specific performance, which would give them a strong bargaining advantage, and at worst they might salvage something between nothing and their expectation interest.

D. The Property Rule and Division of Efficiency Spoils

Due to legal, structural, and market impediments in the real world, a QF cannot purchase replacement energy in the open market for delivery to the utility.[455] Therefore, the immediately preceding

454. As the *Proposed Final Report on SB 1970* reported:

> The evidence presented at our hearings, and the cases that have come before the CPUC, suggest that PGandE takes any contract modification request as an opportunity to eliminate a costly QF, when in fact some modification requests are in the long-run best interests of ratepayers. SDG&E while more cooperative than PGandE, historically has tended to impede some QF development, especially by self-generators. This is inconsistent with SDG&E's short and long-term needs for new supplies, but it occurs nonetheless.

CALIFORNIA ENERGY COMM'N AND CAL. PUB. UTIL. COMM'N, PROPOSED FINAL REPORT TO THE LEGISLATURE ON JOINT CEC/CPUC HEARINGS ON EXCESS ELECTRICAL GENERATING CAPACITY, PUB. NO. 150-87-002, at IV-13 n.6 (Apr. 1988).

455. PURPA only obligates the utility to purchase the electricity generated by the QF. Also, a QF is not usually interconnected in such a way that it can necessarily receive and transmit energy at its point of interconnection. Finally, such purchases and deliveries could only be accomplished through wheeling of electricity through the utility's transmission system. Utility resistance to wheeling long has been an impediment to the development of what would be in this case a cover market. The Energy Policy Act of 1992 may make such a cover market possible for Exempt Wholesale Generators [EWGs], which might suggest that FERC, the appropriate regulatory commission, may be facing future demands for adjudications such as these which have visited the state regulatory commissions following PURPA. Pressure for regulatory involvement in these contracts is likely to be visited upon the state regulatory commissions through prudency reviews of electricity purchased at wholesale or of costs related to utility generation in lieu of such

analysis requires that several obvious additional questions be addressed. First, how can the QF possibly capture some of the efficiency gains inherent in an adjudicated outcome in which specific performance is granted to the QF if the QF does not have a realistic option for buying and delivering replacement energy to the utility? Thus, of what real value would the specific performance entitlement be, given this impediment? Second, why would the CPUC respond to the requests of these parties to adjudicate contractual disputes and provide remedies that are only questionably within its authority when those remedies are unquestionably within the authority of the courts? Even if no issue is made over the question of legal authority, why has the CPUC been eager to affirmatively exercise what would nevertheless be clearly discretionary authority?

The answer to these questions lies in the fact that the CPUC also has an interest in the efficiency gains, and this interest is best served by maintaining its role as an adjudicator of these contractual disputes. This interest also encourages it to give value to the specific performance entitlement through the administrative mechanisms at its disposal. The CPUC's interest has been in capturing some of the

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purchases. This may cause renewed conflicts between federal and state regulation over the constancy of the "filed rate doctrine" and the "Pike County doctrine." *See* Narragensett Elec. Co. v. Burke, 381 A.2d 1358 (R.I. 1977) (preempting state rate regulatory commissions from reconsidering wholesale rate determinations made by FERC); Pike County Light & Power Co. v. Pennsylvania Util. Comm'n, 465 A.2d 735 (Pa. 1983) (allowing rate regulatory commissions to rule on the prudency of wholesale utility purchases at FERC determined rates). For greater detail regarding prospective federal-state tensions in electricity regulation see Charles G. Stalon & Reinier H.J.H. Lock, *State-Federal Relations in the Economic Regulation of Energy*, 7 YALE J. REG. 427, 431-75 (1990). For a hopeful but guarded perspective on the Energy Policy Act of 1992's expected contribution to the development of a more competitive market in electricity, see Jeffrey D. Watkiss & Douglas W. Smith, *The Energy Policy Act of 1992—A Watershed for Competition in the Wholesale Power Market*, 10 YALE J. REG. 447 (1993). For a pessimistic view, see Douglas Gegax & Kenneth Nowotny, *Competition and the Electric Utility Industry: An Evaluation*, 10 YALE J. REG. 63 (1993). Interestingly, both sets of authors converge on a concern over whether the EWGs' wholesale market will truly be competitive. Watkiss and Smith state:

> Perhaps the greatest threat to a long-term competitive power market is that the number of viable EWG competitors may decline, and the remaining few may affiliate with, and become dominated by, electric utility companies. As explained in this Article, there is some evidence that this is already happening.

Watkiss & Smith, *supra* at 491-92. Gegax and Nowtny state more firmly:

> The EWG environment is unlikely to be competitive. Given sunk costs and long-term contracts, the electric utility industry cannot be "contestable". Absent substantial controls, the deintegrated, deregulated electric utility industry will evolve into a tight oligopoly where society will be the loser, and a few lucky investors will be the winners.

Gegax & Nowatny, *supra* at 87.

efficiency gains for the ratepayer, and perhaps at the same time indirectly reconsidering and incrementally modifying the decisions that ordered implementation of the interim standard offers.[456] The way in which the Commission gave value to the possibility of specific performance was to permit the QF to transform itself into a lower-cost producer, the replacement energy producer, either through sale of its contract or through modification or substitution of its contract.

The QF-utility contract adjudications can, however, be more easily understood by deconstructing the adjudicated result into four analytically distinct steps. First, PURPA granted an entitlement which the CPUC converted to a right to a contract. Second, the CPUC protected this right through the threat of imposing on the utilities the remedial legal rule of specific performance, which presumptively awarded potential efficiency gains to the QF. Third, rather than actually ordering specific performance of the contract, the CPUC was more flexible and ordered specific performance of modified or substituted contracts, sometimes with accompanying damages, which permitted the QF to transform itself into a lower-cost producer and assure the realization of efficiency gains. Fourth, the CPUC apportioned the efficiency gains among the three interests, the QFs, the utilities, and the ratepayers.

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456. Indeed, the principal concern of the CPUC has been whether such "settlements" provide ratepayer benefits. Although the parties have on occasion stipulated, as part of the settlement, that there has not been collusion, there is only one case, of rather recent vintage, in which the CPUC has made a finding that there has been no collusion between the utility and the QF. Dec. No. 94-05-058, 1994 Cal. PUC LEXIS 412, at *21. It is not readily apparent why the CPUC, after almost fifteen years of resolving such disputes, addressed the issue so explicitly in a settlement not protested by any outside party and one responded to rather ambiguously by the Division of Ratepayer Advocates. Also, recall, *supra* notes 269-70, that the Pennsylvania Commission concluded that it could not interfere with QF-utility contracts, while the Oklahoma Commission ordered an inclusion of a clause, what is usually termed a regulatory authority clause, in the QF-utility contract which permitted the contracts to be modified from time to time pursuant to its decisions. Early on in the development of the standard offer contracts, the CPUC ordered the exclusion of such regulatory authority clauses, which the California utilities had been including in their contracts. Re Pacific Gas & Elec. Co., Dec. No. 83-09-054, 12 C.P.U.C.2d 604, 628 (1983). In lieu of such a regulatory authority clause the CPUC accepted a force majeure clause. Re Pacific Gas & Elec. Co., Dec. No. 83-10-093, 13 C.P.U.C.2d 84, 125 (1983). The intent was to signal to all parties, particularly the financing community, if not the sanctity of contract, at least the Commission's intention not to undertake modifications in the future. In addition, the force majeure clause would indicate that the utilities were not to be excused from their obligations simply because of excusable non-performance by a QF. Instead, according to force majeure doctrine, the utility's obligation was to be excused only until the QF overcame the force majeure event. The QF was to exert good-faith efforts in noticing and overcoming the force majeure event. The CPUC's case-by-case adjudications of QF-utility contracts essentially permitted it a position between that of the Pennsylvania and Oklahoma Commissions. That is, there was a presumption of non-interference with QF-utility contractual arrangements while permitting it to exercise discretionary equitable authority on a case-by-case basis.

A persuasive argument has been made that a society grants entitlements principally on considerations of efficiency and distribution[457] such as those contained in PURPA.[458] We, the people, entitled QFs to have their power purchased by the utilities at avoided costs through PURPA.[459] The CPUC then converted that entitlement to a legal right[460] when it ordered the utilities to "offer to enter" into "standard offer contracts" with QFs.[461] The CPUC

457. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). The authors allow for the possibility of "other justice reasons," including idiosyncratic ones, as a basis for society granting entitlements, but are hard-pressed to find any which cannot be explained on efficiency or distributional grounds. *Id.*

458. The efficiency considerations are most clearly identified in the cogeneration efficiency requirements. 18 C.F.R. § 292.205(a), (b) (1993). The distributional considerations are clearly evident in the size, fuel choice, and ownership restrictions. 18 C.F.R. § 292.206 (1993).

459. FERC's implementing regulations stopped short of obligating the utilities to contract with the QFs. The regulations only obligate the utilities to purchase the QF's power. The QF is given the option (1) "To provide energy as the qualifying facility determines such energy to be available for such purchases" or (2) "To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term." 18 C.F.R. § 292.304(d) (1993). The term "legally enforceable obligation" is used to allow for the possibility that a utility would refuse to contract with a QF. The section-by-section analysis states that, "Use of the term 'legally enforceable obligation' is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility." Regulations Implementing § 210, *supra* note 209. Presumably, having to design a regulation around the possibility that a utility would refuse to contract with a QF reveals an acceptance or understanding that FERC could not, or at the very least, was not, ordering implementation of PURPA through mandated contracting with QFs. It was, however, expected, as repeated references in the section-by-section analysis to contracts suggest, that both parties would find it in their interest to consummate such purchases through a contractual relationship.

460. *See* H.L.A. Hart, *Bentham On Legal Rights*, *in* OXFORD ESSAYS IN JURISPRUDENCE 171 (A. Simpson ed., 2d series 1973):

> The idea is that of one individual being given by the law exclusive control, more or less extensive, over another person's duty so that in the area of conduct covered by that duty the individual who has the right is a small-scale sovereign to whom the duty is owed. The fullest measure of control [which may not be present in all cases] comprises these three distinguishable elements: (i) the right holder may waive or extinguish the duty or leave it in existence; (ii) after breach or threatened breach of a duty he may leave it "unenforced" or may "enforce" it by suing for compensation or, in certain cases, for an injunction or mandatory order to restrain the continued or further breach of duty; and (iii) he may waive or extinguish the obligation to pay compensation to which the breach gives rise.

Id. at 192 (citation omitted).

461. CPUC Decision No. 82-01-103, implementing FERC's regulations, stated: "This decision orders the major California electric utilities to file standard offers for power purchases based on avoided cost principles. These offers shall be available to all cogeneration and small power facilities that qualify under the Federal Public Utility

then proceeded to protect these contracts through rules that are closer to property rules than to liability rules or inalienability rules.[462]

Interference with the inalienability of contractual rights is incompatible with California contract law, outside the CPUC's authority, and, in any case, has been consistently rejected by the CPUC. The standard offers approved by the CPUC contain a consent-to-assignment clause that permits alienability of the contractual entitlement.[463] The clause states that consent to assignment will not be

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Regulatory Policies Act of 1978." Standards Governing the Prices, Terms and Conditions of Electric Utility Purchases of Electric Power from Cogeneration and Small Power Production Facilities, Dec. No. 82-01-103, 1982 Cal. PUC LEXIS 1296, at *1 [hereinafter Standards Governing Prices]. The CPUC was fully aware that it was implementing Section 292.304 (c) of FERC's regulations, which only required that "standard rates" be put into effect. However, it went on to say, "The rate has relevance only in relation to the mutual obligations of the parties. In this decision we consider the nature and extent of such obligations. The result is the standard offer." *Id.* at *35.

Similar to FERC, the CPUC did not obligate the utilities to contract with the QFs but instead encouraged the option when it said:

> The standard offer has particular significance in terms of the existing and anticipated ratemaking treatment to be afforded utility purchases of energy and capacity provided by QFs. Purchases under the standard offer are per se reasonable and a utility's expenses for such purchases are recoverable in the same fashion as other purchased power expenses . . . without further review. Purchases at rates, terms, or conditions other than the standard offer are recoverable . . . subject to a showing of reasonableness.

Id. The CPUC had made an offer the utilities couldn't refuse.

The entitlement to a "standard rate" had become an entitlement to a "standard offer." But the CPUC did not want to leave any doubt about what that meant, so it defined it rather exactly, both as to content and procedure:

> The term "standard offer" is itself an over-simplification. This decision directs that each utility offer a choice of contract terms at the seller's option. These choices are intended to be economically equal over the life of the contract. It is such equivalence that qualifies each as a standard offer.

Id. at *42-43. The utilities were then ordered not only to make known the availability of a standard offer and its terms and conditions, but also to "offer to enter into a standard offer contract." *Id.* at *138.

462. Calabresi & Melamed, *supra* note 457, argue that entitlements can be protected by property rules, liability rules, or inalienability rules. An entitlement protected by a property rule cannot be taken from the holder unless the holder sells it willingly and at the price he subjectively values the property. An entitlement protected by a liability rule has an external objective standard of value and can be taken from the holder as long as the holder receives the equivalent value in compensation. An entitlement protected by an inalienable rule cannot be sold. These rules have remedial implications. An entitlement protected by a property rule leads to enforcement through specific performance. An entitlement protected by a liability rule leads to enforcement through damages.

463. Order Instituting Investigation to Implement the Biennial Resource Plan Update following the California Energy Commission's Seventh Electricity Report, Dec. No. 92-12-021, 1992 Cal. PUC LEXIS 849, at *50 n.31 ("We note the consent-to-assignment clause, in substantially its current form, exists in all our previous standard offers, including Interim Standard Offer 4.").

unreasonably withheld.[464] Later, when concerns were raised regarding what was considered to be undesirable "brokering" of QF contracts, prohibitions on alienability were proposed, considered, and rejected.[465] In a subsequent adjudication in which the CPUC ruling was unfavorable to the QF, the CPUC nevertheless held that the utility erred when it withheld consent to an assignment.[466]

Efficiency considerations, "new property" protections, and the equitable remedial nexus of the CPUC led to the preference for property rules instead of liability rules for protecting the QF's entitlement, which has now manifested as a standard offer contract. In contractual disputes, the protective liability rule would involve expectation damages and the protective property rule would be specific performance. Protection of the QF's entitlement through the liability rule would entail higher transaction costs[467] than protection through

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464. Union Oil Co., 31 C.P.U.C.2d 338 (1989) stated:

> Neither Party shall voluntarily assign its rights nor delegate its duties under this Contract, or any part of such rights or duties, without the written consent of the other party. . . . Any such assignment or delegation made without such written consent shall be null and void. Consent for assignment shall not be withheld unreasonably.

Id. at *41 (citing the assignment clause in the contract at issue in that case) (ellipses in original).

465. PROPOSED FINAL REPORT SB 1970, *supra* note 105, at 96 ("An outright prohibition against contract 'brokering' will be difficult to enforce. The assignment of a contract from one owner to another is not in itself 'brokering,' because such assignments are allowed under the terms of the standard offer.").

466. *See* Union Oil Co., 31 C.P.U.C.2d 338 (1989). In addressing a dispute over withheld consent by the utility, the CPUC stated:

> The contract itself supplies the answers to the issues concerning assignment. Edison's written consent to the assignment was required for a valid assignment. However, Edison had no right to withhold its consent unreasonably. Edison could reasonably inquire about the ability of the partnership to fulfill Unocal's responsibilities under the contract. Once those inquiries were satisfied, however, Edison should have responded to the formal request for assignment . . . with its written consent to the assignment. This record reveals no reason for Edison to have withheld its consent, and we conclude that Edison was bound under the contract to give its written consent to the requested assignment from Unocal to the partnership.

Id. at *41-42.

467. Recent coverage of litigation between a utility and a QF suggests some of the transaction costs involved. A dispute between three QFs against PG&E apparently has a California Superior Court deeply concerned about the judicial resources a trial would consume. The assigned judge spent two months in settlement conferences hoping to avoid the trial. One lawyer reportedly characterized the court's position as "holding the case hostage." Discovery motions have involved 3000 contested documents and more than 1000 pieces of evidence. The case had already been before 11 different judicial officials: 5 judges, 2 court-appointed referees, and 4 public utility commissioners. Each side had reportedly spent at least $1 million in legal fees by October 1993. If it were to go to trial, the trial could take six months. At stake are approximately $100 million dollars in

the property rule, thereby increasing the possibility of inefficient allocations. Given the long-term nature of the contracts and the limitations of foreseeability and certainty, an accurate determination of expectation damages also would be difficult.[468] Specific performance, on the other hand, places the burden of valuation of the entitlement on the parties best able to determine it — the parties to the contract — and confines the cost of the valuation to those parties. Therefore, it is not surprising that, for efficiency reasons, a preference would develop for protection of a QF's entitlement by the property rule of specific performance.[469]

As mentioned above, the QF's entitlement is a statutorily created entitlement which, as effectuated by the CPUC, resulted in a "right" to a standard offer contract for any QF. The CPUC treated these contracts like property when it provided them the protections normally provided to property. A complaint, petition for modification, or an application that affected a QF's contractual right was processed according to the CPUC Rules of Practice and Procedure[470] which, as a whole, incorporate due process protections for deprivations or threatened deprivations of utility or ratepayer property. They do so because the essence of rate regulation is the regulation of property. Rate regulatory commissions decide what utility property goes into the utility's rate base and what property comes out. The commissions decide the allowable rate of return. These key functions of rate regulatory commissions are constrained by constitutional prohibitions on

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breach of contract and related claims. Yet, the case, *Power Producers Dispute Cases*, No. 2654, is described as a "relatively simple contract dispute." *Court Facing An Energy Crisis*, RECORDER, Oct. 22, 1993, at 1-2.

468. When a common law remedy such as expectation damages is sought, the litigants have a right to a jury trial in a federal court and before most state courts. *See* Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989); Beacon Theatres, Inc. v. Westover, 359 U.S. 500 (1958); *see, e.g.*, FRIEDENTHAL ET AL., *supra* note 11, at 363, 364 § 11.1. When an equitable remedy is sought, there is no right to a jury trial before either court system. A trial by jury not only adds to the transaction costs of the liability rule, but it may also broaden the error band of the computation of expectation damages.

469. If one perceives the role of the CPUC in QF development as being not only an arbiter in matters between the utilities and the QFs but as also including the responsibility to develop a viable market for QF power, then there is additional theoretical support for the choice of a property rule for the protection of the entitlement. *See* Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L. REV. 389 (1993). Frankel concludes that:

> (i) efficient markets require both contract and property rules, (ii) some property rules are designed to satisfy the essential conditions for efficient markets, (iii) contract and property rules may conflict, and (iv) when they conflict, property rules should prevail over contract rules.

Id. at 392. These conclusions are summarized in his normative statement that "efficient markets must rest on coercive rules." *Id.* at 390. Frankel's conclusions and the CPUC's evolved preference for protecting QF contracts with the coercive property rule of specific performance have implications for the development of an efficient market for EWG power.

470. CAL. PUB. UTIL. CODE §§ 1-88 (1993).

the taking of property without due process.[471] More recently, a ratepayer's interest in a utility's administration of rates also has been considered property entitled to due process protection.[472] Recall that the standard offer contract derived from the FERC requirement for a standard rate and that the CPUC considered the standard offer to be a rate.[473] Thus, it is a logical conclusion that if a rate can be entitled to due process protection, and if a standard offer contract is a rate, then the standard offer contract is entitled to due process protection from actions by the CPUC that would threaten that "property." However, the more difficult question of whether a contract is or should be property[474] never had to be addressed since it

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471. *See* Federal Power Comm'n v. Hope Natural Gas, 320 U.S. 591 (1943) (regarding rate of return); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) (regarding "used and useful").

472. Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1 (1978). The Court said:

> Because of the failure to provide notice reasonably calculated to apprise respondents of the availability of an administrative procedure to consider their complaint of erroneous billing, and the failure to afford them an opportunity to present their complaint to a designated employee empowered to review disputed bills and rectify error, petitioners deprived respondents of an interest in property without due process of law.

Id. at 22.

473. *See supra* note 461.

474. This question has been the subject of some debate, particularly since the Constitution makes a distinction in the separate prohibitions against uncompensated takings and impairment of contractual obligations. One scholar has stated: "Historical evidence from the founding period only complicates the puzzle. To the extent that the terms were distinguished, 'contract' seems to have been understood as a subcategory of property. Blackstone, the Framer's leading authority on the common law, treats contract as 'property in action.' " Michael W. McConnell, *Contract Rights and Property Rights: A Case Study in the Relationship Between Individual Liberties and Constitutional Structure*, 76 CAL. L. REV. 267, 274 (1988). But note that in his dissent in Vail v. Board of Education, 706 F.2d 1435, 1450 (7th Cir. 1983), Judge Posner reads Blackstone differently: "In the eighteenth century, as today, contract rights and property rights were distinct. See 2 BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 442-70 (1766); 3 *id.* at 153-66 (1768)."

The Supreme Court also is often cited for the proposition that contracts are property. "The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States." Lynch v. United States, 292 U.S. 571, 579 (1934). In Goldberg v. Kelly, 397 U.S. 254 (1970), the Supreme Court endorsed the broader notion that statutory entitlements are like property. In its now famous, or infamous, footnote 8, the Supreme Court cited with approval a passage from Charles Reich's *Individual Rights and Social Welfare*, 74 YALE L.J. 1245, 1255 (1965), which included government contracts as an example of entitlements that should be accorded the due process protection of property. The Court also cited generally, with approval, Reich's other influential article, *The New Property*, 73 YALE L.J. 733 (1964). *But see* Richard A. Epstein, *No New Property*, 56 BROOK. L. REV. 747 (1990) (criticising *Goldberg* and its "new property" basis).

was so natural and easy to fit it under the CPUC paradigm of regulating property. Thus, the normal everyday processes at the CPUC allowed a gravitation towards protecting QF contracts through a property rule.

The CPUC's gravitation toward the protection of the QF's entitlement through a property rule, specific performance, also was facilitated by the fact that the CPUC's socialized mode of adjudicatory relief is equitable. Very much apart from the fact that it does not have the authority to grant relief through a liability rule, damages, the CPUC would have had an affinity for the property rule, specific performance.[475] Its express constitutional adjudicatory authority of

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It also has been pointed out that the Supreme Court's pronouncements on entitlements as property have lacked a consistent and adequate analytical basis. "[T]he Supreme Court has yet to find a concept of property that both encompasses statutory entitlement and avoids the great expansion of the due process clause." David J. Grais, Note, *Statutory Entitlement and the Concept of Property*, 86 YALE L.J. 695, 696 (1977). There also has been some concern expressed over the preemption implications of treating contracts as property. "In the area of state contracts, the decision to treat a breach of contract as a due process violation could lead to the wholesale replacement of state law by federal law when there is no reason to believe that state courts are failing in their duties." Leonard Kreynin, *Breach of Contract as a Due Process Violation: Can the Constitution Be a Font of Contract Law*, 90 COLUM. L. REV. 1098, 1120 (1990). Consider also Judge Posner's concluding comment in his dissent in *Vail*, a case involving due process violations in an alleged breach of an employment contract: "I regret almost more than I can say that my brethren's method of interpreting precedent has led them to take another step on the road whose terminus is the displacement of the whole of state law in the federal courts." *Vail*, 706 F.2d at 1456.

Finally, a recent article suggests new possibilities of considering the issue of contract as property as well as the interest of ratepayers, or citizens generally, in the contractual relationship between QFs and utilities: "Rights acquired by third party beneficiaries under contracts that are a part of statutory schemes of distribution and protection have a great deal in common with the kinds of rights the Supreme Court has held to be protected property under the due process clauses." Anthony J. Waters, *The Property in the Promise: A Study of the Third Party Beneficiary Rule*, 98 HARV. L. REV. 1109, 1196 (1985). One commentator has described this article in a manner that seems to speak directly to the instant case of PURPA and QF-utility contracts:

> Water's fusion of property, restitution, and contract is another example of the breakdown of jurisprudential boundary lines . . . . Waters goes still further by conflating public and private law: these contracts differ from ordinary third party beneficiary contracts by being directly traceable to some form of public welfare legislation, normally a statute that seeks to achieve a socially desired end not by direct government action, but by a subsidy to a private party in return for his promise to benefit those now seeking to enforce his promise to the government.

PETER LINZER, A CONTRACTS ANTHOLOGY 274 (Peter Linzer ed., 1989).

475. Although this statement might seem tautological at first, we shall see that the CPUC has, on some occasions, awarded relief that includes a component that, but for the absence of the label "damages," happens to be damages. *See infra* notes 488-516 and accompanying text. Presumably, it could have done so more often, or as a consistent preference, but for the collective influence of these factors which I argue led it to evolve a preference for protection of the QF entitlement through a property rule.

reparations is the equitable remedy of restitution.[476] The implied remedial power to grant attorney's fees rests on implied equitable powers over constructive trusts.[477] Essentially, the CPUC thinks and acts in equity. It so apprised itself recently:

> There are various ways in which this Commission can affect contractual disputes between the utilities and QFs. In a line of decisions dating back to at least 1982, the Commission has recognized the advantage that a utility maintains in contract negotiations and in informal dispute resolution. That advantage is derived from the fact that, in many instances, the utility enjoys a monopsonist's control of the QF market. The Commission requires that the utilities bargain in good faith with QFs, and has empowered QFs to file complaints against utilities, asserting failure to bargain in good faith. In considering such complaints, the Commission usually becomes involved in assessing the contractual rights of the parties to the agreement and often directs the utility to perform in a specific manner.[478]

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476. CAL. CONST. art. XII, § 4 ("The commission may . . . award reparation for the exaction of unreasonable, excessive, or discriminatory charges.").

477. *See supra* note 28 and accompanying text.

478. *See* Transmission System Operation: Midset, *supra* note 81, at 6. There is no doubt that the CPUC often has directed the utilities to perform in a specific manner. The authority for the CPUC's doing so in the case of resolution of contractual disputes regarding *performance* of contracts, as the passage suggests and as the actions of the CPUC confirm, is, however, not clear.

See also Standards Governing Prices, *supra* note 461. When the CPUC ordered the utilities to file standard offers it stated, "The Commission will entertain formal complaints raised by QFs who can demonstrate that the utility has failed to bargain in good faith." *Id.* at 137. At the time, however, the CPUC was referring to contract *formation*. *Id.* And, at the time, the authority for the CPUC to require good-faith bargaining was not stated precisely but appears to be the same authority as the one for the standard offers, the FERC rules requiring a standard rate to be developed by the rate regulatory commissions. While the decision also contained a reference early on to the FERC rule requiring state regulatory commissions to commence implementation of PURPA within the year, by (1) issuance of regulations, (2) an undertaking to resolve disputes between QFs and utilities, or (3) any other action, the reference to this rule appears to be used as general authority for implementing FERC's rules through the first option, the issuance of regulations. *Id.* at 7. For this purpose, the CPUC issued an Order Instituting Rulemaking 2 (OIR 2) on September 3, 1980 and this decision was the first major one to issue from that proceeding. Standards Governing Prices, *supra* note 461.

Six years later, in Decision No. 88-10-032, the CPUC required utilities to bargain in good faith when negotiating modifications to *executed* contracts. *Re* Power Purchase Contracts Between Elec. Utils. and Qualifying Facilities, 29 C.P.U.C.2d 415 (1988). Its reference for this expansion of authority was, however, to a vague history. It stated, "*As in the past*, the Commission will entertain formal complaints raised by QFs who can demonstrate that the utility has failed to bargain in good faith since a utility found not to have bargained in good faith stands in violation of the Commission's orders." *Id.* at 428 (emphasis added). However, the intervening CPUC decisions, which address questions of whether the utilities bargained in good faith, concern contract formation and not contract performance. Pacific Gas & Elec. Co., 18 C.P.U.C.2d 264 (1985); Friant Power Auth. v. Pacific Gas & Elec. Co., 11 C.P.U.C.2d 1034 (1983).

The CPUC did discuss, in Standards Governing Prices, *supra* note 461, some independent state authority (Public Utilities Code Sec. 2821) for OIR 2, but it appeared to shy away from specifically basing any part of the decision on such authority, perhaps because

The CPUC directs utilities to perform in a specific manner through "Orders," which is in keeping with the maxim that equity acts in personam. "Decrees in equity were historically written as direct orders to the defendant."[479] Or, as Laycock has stated, "Personal commands also tend to be associated with specific relief, because both are associated with equity."[480] Thus, the equitable remedial nexus of the CPUC also facilitated the preference for protection of the QF's entitlement through a property rule.

The CPUC's preference for the property rule did not, however, lead to a rigid application of the corresponding remedy of specific performance. In this regard it overcame the all-or-nothing result associated either with expectation damages or specific performance as dispensed by the courts. As mentioned above, for the CPUC, the preference for the property rule simply led it to a presumption of specific performance as a point of departure. A review of CPUC decisions resolving contractual disputes indicates that the CPUC was actively involved in dispensing rather flexible remedies while maintaining some form of legal propriety.[481] At its most benign, the CPUC mostly reviewed and approved settlements negotiated by the parties. A more participative description would be that it has mediated contractual dispute resolutions. Some might even say that it has been engaged in "coercive mediation."[482] This article argues that these CPUC decisions have been de facto adjudications in which the CPUC dispensed broad remedies ranging from cancellation to specific performance. In essence, the CPUC has been acting as a court of administrative equity[483] similar to the old equity courts but different in two important respects. First, this court of modern equity, the

the utilities raised the issue of federal preemption. *See id.* at 12, 16. Consequently, the CPUC ambiguously stated early in the decision, "To avoid confusion, we use the terminology and structure of the FERC rules throughout this decision." *Id.* at 12.

479. DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 697-98 (1985); GENE R. SHREVE & PETER RAVEN-HANSEN, UNDERSTANDING CIVIL PROCEDURE 175 (1989).

480. DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE 14 (1991).

481. Apparently there has not been any judicial review of CPUC decisions regarding resolution of QF contractual disputes. One utility did seek judicial review of several related CPUC decisions which modified the energy and capacity prices in the interim long-term standard offer that had been approved by the Commission three years earlier. Pacific Gas & Elec. Co., 22 C.P.U.C.2d 105 (1986); Pacific Gas & Elec. Co. 23 C.P.U.C.2d 1 (1986); Pacific Gas & Elec. Co., Dec. No. 86-12-104, 23 C.P.U.C.2d 414 (1986). Both the California Supreme Court, No. 25114 (S.F. Apr. 30, 1987), and the U.S. Supreme Court, 484 U.S. 853 (1987), denied writ of review petitions.

482. Stewart Macaulay, *Law, Private Governance and Continuing Relationships: An Empirical View of Contract*, 1985 WIS. L. REV. 465 (providing a case example of coercive mediation) [hereinafter *An Empirical View of Contract*].

483. As one administrative law professor wrote:

> Administrative equity serves as a bridge between collectively determined rules and the reality of the particular case. It refers to the substantive principles and

CPUC, is a court of first resort for these parties. Second, it has dispensed flexible remedies, a prospect that has proven difficult for courts, whether acting in equity or law.[484]

The CPUC's early individual adjudications granted specific relief that ordered the utilities to enter into standard offer contracts with QFs which had met the minimum qualifications set forth by the CPUC.[485] This type of relief was consistent with what it had ordered

> norms that may justify individual exceptions to rules of general applicability. Administrative equity is thus primarily concerned with the impact of a regulatory scheme on those required to bear the regulatory costs.

Alfred C. Aman, Jr., *Administrative Equity: An Analysis of Exceptions to Administrative Rules*, 1982 DUKE L.J. 277, 280. Professor Aman cautions that:

> [I]f exceptions to rules are freely and easily granted, with little or no regard for principle, the "inner morality of law" may be jeopardized. Exceptions may not only swallow rules but may leave little or no coherent policy or common law rule in their place. In extreme cases, such processes may result in a patternless collection of cases that grant or deny privileges on an arbitrary basis. Ironically, an arbitrary exceptions regime would be characterized not by too much law, but by no law at all.

Id. at 292. Nevertheless, he finds utility in encouraging a formalized exception process in an increasingly rule-laden administrative state. *But see* Peter H. Schuck, *When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy Through an Exceptions Process*, 1984 DUKE L.J. 163 (providing a more concerned conclusion regarding the consequences of an exceptions process to other administrative law values). Both Aman and Schuck develop their conclusions from studying the same administrative agency, the Office of Hearing and Appeals at the Department of Energy, and its exceptions adjudications. Aman develops what he terms "rhetorical maxims" for administrative equity, which serve as a useful taxonomy for discussing administrative agency justifications for exceptions. Schuck has an interesting discussion of the tension between "conceptions of justice represented by rules and by equity" and the relationship between judicial equity and regulatory equity. *Id.* at 167.

484. A discussion of flexible remedies inevitably raises the *Alcoa* case, Aluminum Co. of America v. Essex Group, 499 F. Supp. 53 (W.D. Pa. 1980), in which the court's remedy was a price adjustment to the contract. The case provoked much commentary and is discussed favorably in most of the articles below, although Professor Macaulay in *An Empirical View of Contract*, *supra* note 482, pointedly commented that it was mainly a decision for scholars to write about, that the remedy was never implemented, and that it was simply the occasion for coercive mediation. *Id.* at 476. Flexible remedies run against the current of established contracts remedial doctrine. Nevertheless, there is good commentary arguing in favor of such judicial flexibility. *See* John E. Coons, *Approaches to Court-Imposed Compromise—The Uses of Doubt and Reason*, 58 NW. U. L. REV. 750 (1964); John E. Coons, *Compromise as Precise Justice*, 68 CAL. L. REV. 250 (1980); William F. Young, *Half Measures*, 81 COLUM. L. REV. 19 (1981); Richard E. Speidel, *The New Spirit of Contract*, 2 J.L. & COM. 193 (1982); Robert A. Hillman, *Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 DUKE L.J. 1. For a traditional reaction, see John P. Dawson, *Judicial Revision of Frustrated Contracts: The United States*, 64 B.U. L. REV. 1 (1984).

485. In Decision 86-07-032 and Decision 86-08-017, the CPUC ordered the specific relief sought by the QFs. The utilities were directed to execute a Standard Offer 2 contract with the QFs upon the QFs curing certain defects in their submittals to the utility. *See* Pacific Gas & Elec. Co., 21 C.P.U.C.2d 405 (1986); Pacific Gas & Elec. Co.,

en masse several times when it received a multitude of petitions and complaints following the suspension of various standard offer contracts or their options.[486] It is not clear, however, whether such relief resulted in any efficiency gains because that would have depended on whether the QF did anything to transform itself into a lower-cost producer following receipt of grants of relief.[487] Even if some of them did effect such a transformation, the gains would have been retained by the QF. Things were to change — in some respects.

In *Energy Factors, Inc. v. San Diego Gas & Electric Co.*,[488] a QF filed a complaint against a utility seeking specific relief of the execution of two standard offer 2 contracts. While stating that it believed the QF could have been entitled to such relief,[489] the CPUC approved a settlement in which the QF settled for standard offer 1 contract terms for energy, which was less than what it would have gotten under the standard offer 2 and probably close to the replacement cost of energy. The QF, however, gained assurance of standard offer 2 contract terms for capacity. The utility, in addition to paying

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21 C.P.U.C.2d 471 (1986).

486. Decision 86-03-069 temporarily suspended the availability of the Standard Offer 2 contracts. *See* Re: Pacific Gas & Elec. Co., 20 C.P.U.C.2d 644 (1986). A number of QFs were caught in various stages of the contract formation process but what they had in common was that they all lacked counter-execution by the utility. Following the suspension, the CPUC received numerous petitions for modification of the decision which would essentially result in execution of the contracts. Instead, the CPUC generally ordered the utilities to counter-execute the outstanding contracts. *See* Pacific Gas & Elec. Co., Dec. No. 86-05-024, 21 C.P.U.C.2d 124 (1986). It cited as precedent the action taken when the CPUC suspended the availability of Standard Offer 4 in Dec. No. 85-04-075 a year earlier. *See* Pacific Gas & Elec. Co., 17 C.P.U.C.2d 521 (1985). The Commission again was, at the time, generally liberal in ordering the utilities to counter-execute outstanding contracts caught in various stages of formation. *See* Pacific Gas & Elec. Co., 18 C.P.U.C.2d 264 (1985). This latter decision discussed at some length the applicability of the contractual doctrines of offer, acceptance, and conditions. Oddly enough, the CPUC ordered the utilities to "sign" all the contracts which had been properly completed, signed, and mailed to the utility by the date of the standard offer 4 suspension — even though it concluded that once a standard offer was accepted by a QF, "the utility is to have no discretion in refusing the agreement." *Id.* at 44, 49. There also had been an even earlier suspension of Option #3 of standard offer 4 announced in Dec. No. 84-10-098, which also had resulted in a claim for specific relief for that option which was granted, Dec. No. 85-02-036. *See* Re Pacific Gas & Elec. Co., 1984 Cal. PUC LEXIS 868 (1984); Re Applications, 1985 Cal. PUC LEXIS 34 (1985).

487. Such transformations are not observable through review of the regulatory record. It would have been in the economic interest of such QFs to seek such transformation. Subsequent assignments of the contracts might be an indicator that some efficiency gains were pursued. Some shift in this direction would have occurred in any case for some QFs that might have been heavily dependent on alternative fuels, whose price was pegged to the dropping price of oil (such as cogenerators which used natural gas as their primary fuel source).

488. Energy Factors, Inc. v. San Diego Gas & Elec. Co., 1986 Cal. PUC LEXIS 596.

489. "Without ruling on the merits of Energy Factors' complaint, we note, however, that Energy Factors had alleged facts sufficient not only to state a cause of action, but to provide a potentially sufficient basis for proving its entitlement to a Standard Offer 2 contract. . . ." *Id.* at *14.

less for energy, also received increased rights to curtail the QF's power deliveries. The parties to the settlement and the CPUC considered these utility gains to be ratepayer benefits. Finally, the new contracts were declared prudent and the utility was assured of ratepayer reimbursement. Although there were clearly some benefits for the utility and/or ratepayer, it is still difficult to ascertain (without knowing the QF's cost of production before and after the adjudication) whether these benefits were the result of efficiency gains or were simply taken out of the QF's expectation interest. Nevertheless, it is a shift in a direction that would have produced such gains if the QF was able to and acted in its best economic interest. In the resolution of this contractual dispute, we see the incipient use of the CPUC's official processes to transform QFs into lower-cost producers and to capture some efficiency gains for the ratepayers at the same time.

The CPUC, however, took a major step in its development of remedial relief in *Solar Turbines, Inc. v. Pacific Gas & Electric Co.*[490] Solar Turbines filed a complaint against PG&E because the utility had refused to counter-execute four standard offer 2 contracts. Both parties stood firmly by their positions and engaged in considerable procedural maneuvering. While Commission action was pending on a motion for summary judgment or alternatively, for summary adjudication of issues, the parties reached a settlement that was promptly approved by the CPUC. The settlement provided that the utility would execute two of the standard offers, each for 12.1 megawatts of firm capacity.[491] In exchange for one of the standard offer 2 contracts, Solar Turbines agreed to obtain assignments and then terminate 55 megawatts of pre-existing standard offer 4 contracts for the same site held by another QF. For the other standard offer 2 contract of 12.1 megawatts of firm capacity, Solar Turbines agreed to give up its claim for 14.1 megawatts and possibly even cancel it if another QF was able to perfect its standard offer 2 for the same site.[492] Solar Turbines also agreed to entirely give up its claim to the other two standard offer 2 contracts, which together amounted to 64 megawatts of firm capacity.[493] The real innovation in the resolution of this dispute was that the utility agreed to pay a lump sum of

490. Solar Turbines Inc. v. Pacific Gas & Elec. Co., Dec. No. 86-12-100, 23 C.P.U.C.2d 348 (1986).
491. *Id.* at 349.
492. *Id.*
493. *Id.* at 350.

$1,080,000 to Solar Turbines.[494] The CPUC agreed to make a finding of reasonableness and allow the utility to recover the costs of the agreed-upon contracts and the lump sum payment.[495]

The CPUC noted that this resolution protected the utility and its ratepayers "from any potential future exposure, should Solar prevail in litigation on any of the PPAs [Power Purchase Agreements], for Solar's compensatory damages (including lost profits) and recovery of its out-of-pocket expenses."[496] The parties alleged that the total ratepayer benefits from downsizing projects, canceling projects, terminating PPAs, and dismissing litigation exceeded $64.5 million, which would accrue to the ratepayer. The CPUC did not accept these estimates as definitive but nonetheless felt that there were "significant savings for ratepayers."[497] The lump sum payment caused the CPUC some pause. It noted that this was the first time it had been asked to approve a settlement that included "a lump sum payment in partial compensation," but it nevertheless proceeded to do so.[498] Procedurally it was, as the CPUC noted, also the first time that the CPUC had reviewed such a settlement ensuing from a complaint, rather than from the regularly scheduled proceeding in which it normally reviews the reasonableness of all the utility's costs.[499] The CPUC had crossed the rubicon.

The CPUC took a much more active role in the *Crockett* case.[500] Crockett cogeneration, a QF, held a 240-megawatt standard offer 4 contract with the local utility.[501] At issue was an invocation by the QF of the force majeure clause of the contract and whether the time for performance would be extended as a result of the invocation. The utility disputed the validity of the force majeure claim but the parties eventually reached a settlement which the utility presented to the CPUC for approval.[502] The settlement included (1) an up-front payment of $17 million to the QF, (2) a payment to the steam host with a net present value of $2.9 million, and (3) an increase in capacity payments to the QF with a net present value of $25.9 million.[503] In exchange, the utility received (1) a five-year deferral of the project and dispatchability provisions it claimed had a value ranging from $26 million to $103 million, and (2) avoidance of the risks of litigation, which Crockett characterized as "compensatory or

494. *Id.*
495. *Id.* at 351.
496. *Id.* at 350.
497. *Id.*
498. *Id.*
499. *Id.*
500. *See* Crockett v. PG&E I and Crockett v. PG&E II, *supra* note 88.
501. Crockett v. PG&E I, *supra* note 88, at 1.
502. *Id.* at 3.
503. *Id.* at 3-4.

greater damages, payable even without the capacity being built and energy being available during that period of delay."[504] The settlement was opposed by a number of parties including the CPUC's own Public Service Division, now renamed the Division of Ratepayer Advocates.[505] Among other things, those who protested the settlement challenged the estimated ratepayer benefits and the validity of the force majeure claim (essentially the corresponding risk to the utility in litigation) and the viability of the project without the deferral.[506] Those who protested claimed that the ratepayers actually would be harmed rather than benefitted through the salvaging of the project by the proposed settlement.[507]

The CPUC rejected the proposed settlement. It concluded that the estimated advantage to ratepayers under the most reasonable scenario ranged from $12.7 million to $59.8 million.[508] Therefore, the upfront payment and the payments to the steam host were excessive and also totally at risk since they were not tied to the project's realization in any way.[509] The CPUC also found that the settlement did not fully mitigate the risks of litigation[510] because Crockett did not really release the utility from all potential claims.[511] The CPUC, however, set forth the terms of a settlement that it would accept and assured the parties that a such a revised settlement would be considered "reasonable and fully recoverable from ratepayers."[512] It was an offer that could not be refused. The CPUC also noted, presumably as a signal to the utility, that if a court found the utility liable for damages, it "would at least raise an issue for us of whether any PG&E imprudence had occurred in the administration of this contract."[513]

The parties returned to the CPUC with a revised settlement that eliminated the utility's payment to the steam host, approximately $3 million, and tied the $17 million payment to Crockett to project development milestones. In addition, the QF released PG&E from any and all potential claims in a general release and covenant not to

504. *Id.* at 4-6.
505. *Id.* at 6-10.
506. *Id.* at 6-9.
507. *Id.*
508. *Id.* at 21.
509. *Id.*
510. *Id.*
511. *Id.* at 18.
512. *Id.* at 19.
513. *Id.* at 17-18.

suc.[514] The settlement received swift approval. The total turn-around time took about three weeks.[515] A subsequent petition for rehearing (eventually denied) and a petition for modification (also denied) resulted in yet another decision principally devoted to explaining why the CPUC found the settlement reasonable.[516]

This series of decisions illustrates how the CPUC involved itself more and more in the contractual disputes between the parties. It also shows how the remedies varied from what can be characterized as specific performance to what are, by any other name, damages. Whatever the remedy, the coercive backup was the threat of a property rule, specific relief.[517] Through it all, the presumed beneficiary of the increased involvement was the ratepayer. The attempt to capture benefits for the ratepayer, however, was mostly without a sufficient analytical basis that could inform the CPUC whether its reallocations were efficient regardless of the particular choice of remedy.[518] Capturing benefits for the ratepayers became a proxy for pursuing efficiency gains. Because it became easier to capture such benefits, determination of whether the permitted assignments and transformations of the QFs into lower-cost producers actually met the necessary tests for efficient reallocations was foregone. Lost in the paper exchanges of the adjudications before the CPUC was the fact that the case-by-case efforts to capture efficiency gains through those disputes that surfaced before the CPUC barely touched the surface of the hundreds of contracts with potential efficient reallocations that were not being addressed by broader policies that would have encouraged those reallocations, possibly to everyone's benefit.

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514. Crockett v. PG&E II, *supra* note 88, at 5.

515. *Id.*

516. Pacific Gas & Elec. Co., 29 C.P.U.C.2d 644 (1988).

517. There were a few instances in which the CPUC did deny relief completely, even of a proposed settlement. *See* West Contra Costa, *supra* note 89 (denying a settlement); Friant Power Authority, 11 C.P.U.C.2d 1034 (1983) (denying requested relief for execution of a non-standard contract).

518. *See* Pacific Gas & Elec. Co., 36 C.P.U.C.2d 342, 354 (1989) ("We should point out that settlements such as these can create problems for Commission analysis. In this case, analysis of the settlement assuming that PG&E would have prevailed in court proceedings was absent."); Re: Power Purchases From Cogenerators and Small Power Producers Located Outside of the Purchaser's Service Area or Outside of California and the Terms and Conditions Which Should be Applied to Such Purchases, 37 C.P.U.C.2d 194 (1990):

> While we find that the reasonableness of the settlement is a fair resolution of the dispute between Edison and Yankee, the reasonableness of the settlement from the ratepayers perspective is less apparent. The total savings which ratepayers are alleged to receive from the settlement will be realized only under very specific and uncertain assumptions. . . . Under different assumptions, the settlement could be found to impose additional costs on ratepayers. . . . We find the estimated savings in energy payments to be equally speculative and uncertain.

Id. at *11-12.

Who knows how many extant QFs proceeded to construct and operate profitably but would have preferred to operate perhaps a little bit more profitably while generating not only power but efficiency gains that could have been shared, had they not been deterred from raising the prospect of modifications or deferrals because of the narrow emphasis the CPUC placed on recapturing maximum benefits for the utilities and/or ratepayers. The CPUC was in pursuit of a laudable goal but one that might have been better pursued had it exercised administrative restraint and confined its role to that which was originally intended and to which it could have tended better — that of setting rates for purchase of QF power and eliminating impediments to the availability of those rates to QFs. The CPUC should have left contractual matters, especially disputes over performance and contract modification, to be worked out between the parties as the administrative law judge suggested in *Colmac* and *Unocal* — before forums better suited for those endeavors.

Exercising restraint in responding to the utility call or QF call to adjudicate their contract disputes would channel these disputes into courts which can exercise equal authority over both utilities and QFs. The court, in addition, can draw on the full range of remedies, unconstrained. There, the burden of assessing the strength of contractual claims is appropriately placed on the parties to the contract. It would be their burden to incorporate their risk-aversion curves and appraise probable court outcomes in deciding whether to litigate or negotiate a settlement.[519] The CPUC's development of the preference for protection of the QFs' entitlement through a property rule should be, however, a positive lesson to the courts when ruling on matters that involve statutory entitlements intended to develop markets. However, if Laycock's observations are correct, there does not have to be great concern that the courts would not respond positively to requests for specific performance, which, in the case of QF power development, appears to have been most helpful.

At worst, however, even resolution of contractual disputes before the courts with a preference for a liability rule of damages is not necessarily a bad thing in comparison to an ad hoc remedial scheme that has a preference for the property rule. The debate between the

519. As Priest wrote: "[L]itigation is likely to occur chiefly when the parties disagree over what the court will find the efficient outcome to be." George L. Priest, *Selective Characteristics of Litigation*, 9 J. LEGAL STUD. 399, 410 (1980); *see also* George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984).

efficiency of specific performance and expectation damages is not whether one is efficient and the other is not, but over which one is more efficient in particular circumstances. It may be that in the circumstances we have been discussing the difference in the efficiency results may not be as important as encouraging efficient reallocations wherever possible. As the discussion above indicates, the difference between the two remedies was principally an immediate distributional opportunity, benefits to the ratepayers, which would appear to be more remote if the courts were the forum for the resolution of these disputes. The real benefit to the ratepayer, however, lies in an efficient QF power market, not in occasional bilateral contract adjustments of questionable efficiency. Administrative restraint in adjudicatory involvement in third-party utility supplier contracts (in this instance they happen to be power contracts) best serves the ratepayer and the larger society PURPA intended to benefit.

VI. A Role for Administrative Restraint

It had proven unwise to rely on one who participated in the promise-making process to settle disputes regarding the validity, interpretation, and performance of that same promise.

The CPUC has a difficult problem. It has a federal mandate to implement a program involving QFs and utilities but it only has regulatory authority over the utilities. Moreover, it is in the front line of this implementation effort but gets little support from its slower-acting regulatory overseer, the Federal Energy Regulatory Commission (FERC). The CPUC was conscripted into the "national bureaucratic army"[520] to fight a war that everyone forgot and for which few have remaining enthusiasm. Frustrations show in the need to balance: (1) the quite natural monopolistic urges of the utilities; (2) ratepayers who want least cost electricity now; and (3) QFs that wish to retain the benefit of the bargain struck when they answered the call to fight the moral equivalent of war. All this must be resolved by the CPUC, while at the same time avoiding being captured by the industries it is supposed to regulate.[521]

The CPUC has been overwhelmed because it has mirrored the monopolies it attempts to regulate. Instead of seeking to increase its market share of adjudicatory authority, the CPUC should seek to narrow it to areas where it can be most effective. It needs to refocus on its primary charge — to regulate the service between the utilities

520. Federal Energy Regulatory Comm'n v. Mississippi, 456 U.S. 742, 775 (1981) (O'Connor, J., dissenting).

521. *See generally* MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSIONS (1977).

under its authority and the ratepayers. The principal and very powerful tool in its possession is its authority to determine the utilities' revenue requirements. The ability to adjust revenue requirements of a utility is a powerful behavior modification tool. When the CPUC ventures afield from interface between the ratepayer, whose terms and conditions of service are wholly within the authority of the CPUC, and the utility, whose revenue requirement is wholly within the authority of the CPUC, it is going to be much less effective. This is so because it is bound to procedures unsuited to its new endeavor and has no effective mechanism to modify the behavior of parties that are not under its economic regulatory wing. The CPUC's efforts to regulate more than it had to in the interface between the utilities and QFs is a good example of the difficulties it will always encounter in its efforts of regulating so directly when dealing in these interfaces. It should have learned from the experience of trying to do the same thing in its effort years ago to regulate the interface between the telephone companies and their affiliates. This is, after all, a generalizable experience. It is simply the interface between the utility and a third-party supplier. It is time to reconsider the benefits that would accrue from exercising administrative restraint.

A. *Primary Jurisdiction*

The California Legislature provided that,

> No court of this State, except the Supreme Court, to the extent specified in this article, shall have jurisdiction to review, reverse, correct, or annul any order or decision of the commission or to suspend or delay the execution or operation thereof, or to enjoin, restrain, or interfere with the commission in the performance of its official duties.[522]

The judicial review provision must, however, be reconciled with another legislative provision which states that, "An action to recover for . . . loss, damage, or injury [caused by a public utility] may be brought in any court of competent jurisdiction by any corporation or person."[523]

The interplay of these two provisions usually results in a primary jurisdiction argument raised before a court when a party has filed under Section 2106. The doctrine of primary jurisdiction is a judge-made doctrine leaving the court a high degree of discretion to direct disputants to an agency that presumably has more expertise than the court in the subject matter of the dispute. The court will either send

522. CAL. PUB. UTIL. CODE § 1759 (West Supp. 1992).
523. CAL. PUB. UTIL. CODE § 2106 (West Supp. 1992).

the whole dispute or part of the dispute to the agency while it stays proceedings and awaits the agency's disposition of the matter. The academic explanation of primary jurisdiction is that a court is seeking the expertise of an agency or that there is some virtue in obtaining uniformity of decisions in a subject matter within that agency's expertise.

However, it is not often the case that the court, on its own, will direct disputants to the agency. A primary jurisdiction argument is usually made in a motion to dismiss a complaint filed in a court by a party seeking a more amenable forum. That party is usually a utility that has been brought to court under Section 2106 of the Public Utilities Code. The utility will file a concurrent "application" or "petition" before the CPUC and assert that its filing constitutes an acceptance of jurisdiction by the CPUC and that a proceeding is now ongoing that would require the court to respect the expertise of the CPUC. The utility may also be seeking a forum in which there can be a direct appeal to the Supreme Court. There is, after all, some economy in that route. Quite often the utility also is seeking the collateral estoppel effect of an agency decision.[524] On occasion, the regulatory agency will intervene to preserve what it perceives to be the integrity of its jurisdiction.

Some exercise of administrative restraint in these two instances would serve the CPUC well. In the first instance, the CPUC could strictly scrutinize the utility's filing to see whether it could indeed be a matter that the court could adequately handle and in which the expertise of the CPUC is not needed. If the CPUC so determines, it could then dismiss the application or petition by the utility. There is some evidence that the CPUC is more inclined in this direction than has been the case in the past.[525] In the second instance, the CPUC merely has to refrain from affirmatively seeking primary jurisdiction.

B. Prudent Management Review

A rate regulatory commission like the CPUC very easily can be drawn into a micro-regulatory mode. A utility has to apply to the CPUC for permission to collect a certain amount of revenue to cover

524. Thomas F. Crosby, Jr., *Administrative Collateral Estoppel in California: A Critical Evaluation of* People v. Sims, 40 HASTINGS L.J. 907 (1989); Rex R. Perschbacher, *Rethinking Collateral Estoppel: Limiting the Preclusive Effect of Administrative Determinations in Judicial Proceedings*, 35 U. FLA. L. REV. 422 (1983).

525. *See* Transmission System Operation: Midset, *supra* note 81; Energy Factors, Inc. v. San Diego Gas & Elec. Co., 1986 Cal. PUC LEXIS 596; North County Resource Recovery Assocs. (NCRRA) v. San Diego Gas & Elec. Co., Dec. No. 91-06-048, 1991 Cal. PUC LEXIS 375, 40 C.P.U.C.2d 626 (1991). In *NCRRA* the CPUC simply stated: "The superior court is qualified to interpret the terms of the PPA as well as published Commission decisions in order to resolve this contract dispute." 1991 Cal. PUC LEXIS at *8.

its expenses and to give a fair rate of return to its shareholders. If the CPUC does not allow enough of a revenue return, it is possible that its action could be considered confiscatory. The standard that has developed is that a "fair rate of return" is that return necessary for the utility to attract capital. Thus, the utility goes through a process every few years in which the CPUC scrutinizes the utility's expenses to see if it will allow a reimbursement. Once in a while, just often enough to keep the utility management's attention, a regulatory commission will disallow some expenses. This is, however, rare.

Utilities, like any other business, make mistakes that result in increased expenses. The rule that has been developed to determine whether those expenses will be reimbursed by the ratepayers is called the "prudent management" rule. If the CPUC determines that the decision that caused the increased expenses was prudent, then reimbursement is allowed. If it was imprudent, reimbursement of the expenses is disallowed. Disallowed expenses must then be covered by shareholder earnings. This puts pressure on utility management to minimize the potential for non-reimbursement. Management does so by transferring decision-making to the CPUC through requests for advance assurances of reimbursement, which clog up the CPUC docket.

Utilities seek advance guarantees of the reimbursibility of major expenses or risky endeavors. For example, many of the early QF contracts were negotiated between the utilities and the QFs. Utilities included a clause making a contract contingent on CPUC approval. The utilities thus insulated themselves from the risks that expenses might be disallowed in a later review. In part, the CPUC developed the standard offer contracts so that it would not have to go through that process for every contract. The CPUC adjudications of QF-utility disputes often are intricate maneuvers by the utility to obtain such assurances for sometimes rather minor contract changes.

The CPUC should exercise administrative restraint and decline to address such insecurities by the utilities. Utility management should be made to assume the risks of their decisions. In the past, it used to be considered an invasion of management prerogative for the CPUC to involve itself in the adjudication of utility contracts with third-party suppliers such as the QFs.[526] In a celebrated case in which the California Supreme Court held that the CPUC had no authority to interfere with third-party contracts, Justice Traynor wrote:

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526. *See* Note, *"Management Invaded"—A Real or False Defense?*, 5 STAN. L. REV. 110 (1952).

> The determination of what is reasonable in conducting the business of the utility is the primary responsibility of management. If the commission is empowered to prescribe the terms of contracts and the practices of utilities and thus substitute its judgment as to what is reasonable for that of the management, it is empowered to undertake the management of all utilities subject to its jurisdiction. It has been repeatedly held, however, that the commission does not have such power.[527]

This decision was the foundation for many to follow.[528]

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527. Pacific Tel. & Tel. Co. v. Public Util. Co., 34 Cal. 2d 822, 828 (1950).

528. Traynor's decision had a good deal of precedent to support it. *See, e.g.*, Hanlon v. Eshleman, 169 Cal. 200 (1915). The California Supreme Court wrote:

> With the rights of an intending purchaser the commission has nothing to do. Nor has it power to determine whether a valid contract of sale exists, or whether either party has a legal claim against the other under such contract. These are questions for the courts, and not for the railroad commission . . . .

Id. at 203; Atchison, Topeka & Santa Fe Ry. Co. v. Railroad Comm'n, 173 Cal. 577, 582 (1916) (citing *Eshleman* and holding "the railroad commission is not a body charged with the enforcement of private contracts"); Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276, 289 (1922) ("It must never be forgotten that while the State may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies and is not clothed with the general power of management incident to ownership.").

Court and CPUC decisions have distinguished *Pacific Telephone* in order to permit regulatory interference in situations which bear directly on the relationship of the utility to the customer. *See, e.g.*, General Tel. Co. v. Public Util. Comm'n, 670 P.2d 349, 355 (1983) (questioning *Pacific Telephone's* continued vitality in dicta but characterizing the "commission's attempt . . . to dictate the terms of a contract between the utility and its parent" as a "typical instance of unnecessary intermeddling" and affirming the process of prudency review).

However, regarding third party contracts, Traynor's rule in *Pacific Telephone*, that the CPUC may not substitute its judgment for that of the utility's management, remains good law. *See, e.g.*, Stepak v. American Tel. & Tel. Co., 186 Cal. Rptr. 37, 40 (1986) ("The matter is all but settled by the Supreme Court's decision in Pacific Tel. & Tel. Co. v. Public Utilities Comm'n, 334 P.2d 887 (1959)."). Citing *Atchison, supra*, the court held:

> [T]he . . . commission is not a body charged with the enforcement of private contracts. Its function . . . is to regulate public utilities and compel the enforcement of their duties to the public, not to compel them to carry out their contract obligations to individuals. The commission cannot "modify" a public utility's contract or order a public utility to perform a contract, whether "modified" or "unmodified."

Id. at 893. Other state courts have cited *Pacific Telephone* with approval. *See, e.g.*, General Tel. Co. v. Lundy, 218 N.E.2d 274, 278 (1966) (approving prudency review and citing *Pacific Telephone* the court writes "the commission is powerless to *impair* the obligation or otherwise *invalidate* a utility's contract").

CPUC decisions reflect the Traynor holding and its focus on utility-producer relationships. Citing *Pacific Telephone* the Commission wrote:

> We have no jurisdiction to order PG&E to breach any of its producer supply contracts, nor to relieve it of the civil obligations created thereby. Even if we were to find the basic contract or the new prices unreasonable, the most we could do is to disallow the unreasonable portion of the resulting cost thus shifting a part of the economic burden from the consumer to PG&E's stockholders.

Pacific Gas & Elec. Co., Dec. No. 82224, 76 C.P.U.C. 134, 139 (1973); *see also* Pacific Lighting Gas Co., Dec. No. 58677, 57 C.P.U.C. 230 (1959) ("The Commission does not have power to regulate contracts by which a utility secures labor, materials and services for the conduct of its business."); Pacific Gas & Elec. Co., Dec. No. 84902, 78 C.P.U.C. 638, 756 (1975) ("Our ability to pass on the terms and conditions of a contract between

Interestingly, the CPUC has respected Traynor's approach in theory and practice in all areas of its regulatory authority, such as telecommunications, water, transportation, and even with respect to electric utility procurement of fuel supplies. The interventionist approach it has followed with respect to QFs has been rather singular. With respect to other third-party supplier contracts, the CPUC has, at most, rattled sabers by disallowing major fuel expenses,[529] launching major prudency reviews,[530] and finding major fuel contracts by one utility imprudent,[531] which led the others to breach their contracts. Those that breached their contracts were reimbursed for litigation and settlement costs since those decisions were considered prudent.[532] Exercising restraint from interfering with third-party

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a utility and its suppliers . . . is limited to seeing that unreasonable costs are not passed on to the rate payer."); Pacific Gas & Elec. Co., Dec. No. 85752, 79 C.P.U.C. 795, 802 (1976).

The CPUC has also construed *Pacific Telephone* to limit its interference in labor disputes. *See, e.g.*, General Tel. Co., Dec. No. 92366, 1980 Cal. PUC LEXIS 893. Citing *Pacific Telephone* the Commission wrote: "In the absence of statutory authorization, however, it would hardly be contended that the commission has power to formulate the labor policies of utilities, to fix wages or to arbitrate labor disputes." *Id.* at *189.

Traynor's 1950 decision is persuasive authority to limit CPUC intermeddling in utility-QF contracts today, especially considering the CPUC's intent to limit their interference in these contracts. The CPUC has asserted that it has no interest in intervening or rewriting contracts. In discussing its appropriate role regarding nonstandard offers between utilities and QFs the CPUC wrote: "We do not believe it will be necessary or appropriate to become involved. Utilities and QFs are to negotiate with each other, and we will review the product for approval or disapproval. We have no intention of intervening or rewriting contracts." Commission Rules Regarding Electric Utility Purchases of Electric Power From Cogeneration and Small Power Production Facilities, No. 82-01-103, 8 C.P.U.C.2d 20, 84 (1982). In rejecting a utility request to modify utility-QF standard offer contracts, the Commission stated:

> We had conceived that the contracts formed as a result of our standard offers would become conventional bilateral contracts once the offer was accepted and we have consistently tried to respect the terms of the parties' agreements. We are not inclined to dictate language for amendments to executed contracts in the absence of the consent of both contracting parties.

Order Instituting Investigation to Implement the Biennial Resource Plan Update Following the Cal. Energy Comm'n's Seventh Electricity Report, No. 93-11-019, 1993 Cal. PUC LEXIS 852, at *5 (1993). Later in the decision the CPUC writes: "Our concept when we commenced the QF program was that, once the initial bargaining disparities were overcome, utilities and QFs would deal with each other in a usual commercial manner, as parties to a sales agreement." *Id.* at *8.

529. PG&E Authorized to Decrease Rates, Dec. No. 82-12-109, 10 C.P.U.C.2d 488 (1982).

530. Re Pac. Gas & Elec. Co., 16 C.P.U.C.2d 457 (1984); Re San Diego Gas & Elec. Co., 14 C.P.U.C.2d 352 (1984).

531. SDG&E Executed Imprudent Fuel Oil Exchanges, Dec. No. 82-08-018, 9 C.P.U.C.2d 551 (1982).

532. Re Southern Cal. Edison Co., 24 C.P.U.C.2d 476 (1987).

suppliers, such as QFs,[533] and focusing instead on managing the quality of decision-making through the prudency review of management decisions is a preferred option.[534]

533. Interestingly, the QF case in which the CPUC most directly addressed the issue of management prudency was decided against a QF. There the CPUC stated:

> [O]rdinarily, in the absence of compelling circumstances, utility management should apply its expertise and judgment within the regulatory parameters we set; we must ensure the parameters are fair and in the overall public interest, but we should not directly "manage." By the nature of the relief Friant requests it is asking us to substitute our judgment for that of utility's management. We will however make a ratemaking adjustment if we find a utility had a lower cost option for power (e.g., QF power) which it did not exercise, or otherwise acted imprudently.

In re Friant Power Authority, Dec. No. 83-06-109, 1983 Cal. PUC LEXIS 30, at *7.

534. It does appear that the CPUC is coming to a belated recognition that development of a market-oriented electric services industry requires that the CPUC refrain from the temptation to respond to requests to adjudicate contractual disputes between utilities and new entrants to the electricity generation market and to instead view such electricity contractual relationships in the same manner as utility procurement of other goods and services. *See* Order Instituting Investigation on the Commission's own Motion to Implement the Biennial Resource Plan Update Following the California Energy Commission's Seventh Electricity Report (I.89-07-004) and Order Instituting Investigation on the Commission's own Motion to Develop a Policy on Nondiscriminatory Access to Electricity Transmission Services for Nonutility Power Producers (I.90-09-050), Dec. No. 92-10-049 (1992), 1992 Cal. PUC LEXIS 913. The CPUC stated:

> Equally important, we hesitate to further involve this Commission in utility procurement practices, when one of the main goals of this program is to reach a point where the utilities routinely solicit bids for electric supply under general guidelines of prudence and good business sense, much as they now seek bids for goods and services they use in the course of their operations. The California Supreme Court has upheld this Commission's authority to require competitive procurement procedure by a utility, without suggesting the Commission thereby had to assume jurisdiction over contract disputes arising from such procedure. (See General Tel. Co. of Cal. v. Cal. Pub. Util. Comm'n, 34 Cal.3d 817, 195 Cal.Rptr. 695 (1983).)

Id. at *21.

The CPUC repeated this sentiment in Dec. No. 94-06-047 (June 22, 1994), slip op. at p. 8, where it next logically addressed what its expectation would be if and when contractual disputes arose. With respect to some type of contractual disputes likely to arise from the bidding process the CPUC pointed out that the Requests for Bids required the bidder to accept mandatory binding arbitration, slip op., n.4 at p.8. With respect to other types of contractual disputes that might arise from performance, the CPUC called the parties' attention to section 2-615 of the Uniform Commercial Code which "contemplates modification as an alternative to excusable nonperformance in the face of what is termed a 'failure of mutually presupposed conditions.' Should subsequent developments assume such a dimension, we would expect the parties to modify or adjust their relationship in a mutually agreeable way at some future date." *Id.* at p.15.

This section of the Decision and the "heated debate" it engendered led CPUC observers to conclude that the CPUC was directing such contractual disputes to the courts. *See* California Energy Markets, July 1, 1994, at 13-15 ("[C]ontroversial wording about future contract renegotiations reflects the CPUC's desire to have parties rely on civil law, rather than regulatory involvement, to adjust their relationships in response to an uncertain future.").

VII. Conclusion

. . . the basis of the current tradition of special judicial tribunals for the enforcement of promises . . . was the result of bad experience when the country had only one ruler who . . . enforced his own promises.

This article began by establishing the fact that the extent of the remedy the CPUC could lawfully grant was reparations, a restitution remedy. The article ended with an argument that an adjudicatory body must have the authority to grant actual damages in order to settle disputes most efficiently, in an economic sense. In between these two points it was shown that the present state of federal and state constitutional law would not permit such a grant of authority to administrative agencies. That leaves the situation with the prospect that regulatory bodies in general, and the CPUC in particular, do not serve the best economic interests of society by adjudicating contract disputes.

Contract disputes must be channeled into the state courts, the appropriate adjudicatory authority able to provide the full range of remedies. In the absence of such remedial authority, the most economically efficient alternative for regulation, also one which comports with a deregulatory approach, focuses on regulating management decision-making through the prudency review process, rather than through the regulation of contracts with third-party suppliers.

The potential disallowance of unchallenged, inefficient contracts as imprudent when the market has changed drastically, with reimbursement of settlement costs or damages to the utility when a breach is deemed prudent, is a workable substitute for an expectation damage remedy. With the flow-through of expenses that is the method of rate regulation used by utility commissions, it is the ratepayer who is the ultimate buyer of the third-party good and, therefore, the ultimate party to the contract. It is the ratepayer who pays off the expectation interest paid to the third-party supplier.

The implication for the adjudication of QF-utility contract disputes is that it is in everybody's best interest to channel the disputes into the courts. This article has shown that the federal and state constitutions, the federal and state statutes, the embedded value for efficiency in the common law and the evolutionary pull of efficient legal rules argue for this approach. The CPUC needs to align itself with that effort. If some circumstances result in which such disputes unavoidably present themselves to the CPUC, the best thing to do is to place the burden of making a decision on the utility and be willing to reimburse the utility for the consequences of either honoring the contract or breaching it if that decision is determined to be prudent.