

*Report of The Committee on
Regulations Under Part I of the Federal Power Act*

The major developments during 1984 in the field of hydroelectric licensing centered on the continuing evolution of the law in areas of prior controversy. These included the application of municipal preference both in licensing and relicensing; the continuing tension between the FERC's duty to expedite the licensing process through granting exemptions to small projects versus its duty to examine the environmental effects of all projects under its jurisdiction; the conflicting jurisdiction over hydroelectric projects among the FERC, other federal agencies charged with regulation in areas affected by hydroelectric projects and the states; and the question of annual charges on hydroelectric projects. These issues were the subject of discussions and decisions in Congress, before the federal courts and at the FERC. The developments during 1984 in these and other issues will be discussed in this Report by topic.

I. DEVELOPMENTS INVOLVING THE STATUS OF LICENSE APPLICANTS AND HOLDERS

A. *Municipal Preference*

1. *Congressional Proposals Concerning Preference On Relicensing of Existing Hydroelectric Projects Under The Federal Power Act*

During the 98th Congress several bills were introduced to address the controversial issue of state and municipal preference under Section 7(a), 16 U.S.C. § 800(a), of the Federal Power Act in relicensing proceedings. Legislative interest was stimulated by the pendency of several competitive relicensing proceedings before the FERC, particularly the "Merwin" case, *Pacific Power & Light Co.*, 25 FERC ¶ 61,052, *reh'g. denied*, 25 FERC ¶ 61,290 (1983). The Commission decided in favor of the existing licensee, Pacific Power & Light Co., thereby reversing the decision of an FERC administrative law judge issuing the license to the municipal competitor, Clark-Cowlitz Joint Operating Agency (CCJOA).

The Commission decision in the *Merwin* case also reversed its own earlier Opinion Nos. 88 and 88-A in *City of Bountiful, Utah*, 11 FERC ¶ 61,337, *reh'g. denied*, 12 FERC ¶ 61,179 (1980), which had determined that states and municipalities in relicensing proceedings have a tie-breaking preference under Section 7(a) of the Federal Power Act. The *Bountiful* opinion was affirmed by the 11th Circuit in *Alabama Power Co. v. FERC*, 685 F.2d 1311 (11th Cir. 1982) and certiorari was denied on the question, *Utah Power Light Co. v. FERC*, 103 S. Ct. 3573 (1983). An appeal from the Commission's decision in *Merwin* was taken by CCJOA and the case is *pendente lite* in the U.S. Court of Appeals for the District of Columbia Circuit, *Clark-Cowlitz Joint Operating Agency v. FERC*, No. 83-2231, argued October 18, 1984.

A congressional proposal introduced by Congressman Shelby of Alabama, H.R. 4402, would require relicensing of existing licensees whose plans meet the "best adapted" standards of Section 10(a) of the Federal Power Act, and would require payment of "just compensation" as determined by the Commission in the event of relicensing to a new applicant. H.R. 5299, introduced by Congressman

Ottinger, then Chairman of the House Subcommittee on Energy Conservation and Power (which held hearings on the several relicensing bills on May 17, 1984), would codify the *City of Bountiful* decision, by expressly providing for state and municipal tie-breaking preference on relicensing. The bill also permits an optional payment by the competing applicant to the existing licensee, presumably as a set-off against any economic impact of the transfer on the existing licensee's customers. This amount would be in addition to the statutory standard of "net investment" and "severance damages" under Section 14(a) of the Federal Power Act. H.R. 5416, introduced by Congressman Gore of Tennessee, would make cooperatives eligible for the municipal preference on relicensing under the FPA and provide for anticipatory antitrust review of all relicensing applicants by the Attorney General. The antitrust provisions were modeled after the antitrust review required for licensing nuclear plants under the Atomic Energy Act.

S. 2710; a companion bill to H.R. 4402, was introduced in the Senate. S. 2711, introduced late in the 98th Congress by Senator Johnston of Louisiana, would have required the Commission to issue a new license to an existing licensee unless the Commission determined that the plans of another applicant were better adapted to serve the public interest. The bill also would have spelled out the criteria used to determine the "public interest" in such circumstances. The bill did not address compensation.

No further action was taken in either house following the House Energy and Conservation Subcommittee's hearings on May 17 and the bills died with the 98th Congress. On January 3, 1985, Congressman Shelby re-introduced his earlier bill, as H.R. 44; other bills are expected to be introduced in both the House and Senate, and Congressional action on this issue seems likely during the 99th Congress.

2. *Court Actions Concerning Municipal Preference Under the Niagara Redevelopment Act*

On August 15, 1984 the Second Circuit in *Power Authority of the State of New York v. FERC*, 743 F.2d 93 (2d Cir. 1984) affirmed in part and modified in part the Commission's Opinion Nos. 151 and 151-A, *Municipal Electric Utilities Association of the State of New York v. Power Authority of State of New York*, 21 FERC ¶ 61,021 (1982), modified on reh'g., 23 FERC ¶ 61,031 (1983). Under the terms of the Niagara Redevelopment Act, 16 U.S.C. §§ 836-836(a), which authorized the Commission to issue a license for the Niagara Power Project, the Power Authority of the State of New York ("PASNY") was required to give preference to municipal and cooperative systems in disposing of 50% of the Project power. To the extent such systems did not need that share of the Project power, the Act authorized PASNY to sell it to private utilities subject to flexible arrangements and contracts for the withdrawal, upon reasonable notice, of amounts of power which would meet the reasonably foreseeable needs of the preference customers.

In Opinion No. 151 the Commission found that PASNY had unreasonably underestimated the load growth rate and foreseeable needs of the preference customers when it executed power sale contracts in 1960-61 with private utilities and had failed to make the kind of "flexible arrangements" which the Act required for the withdrawal of power. The contracts were to terminate in 1989, but PASNY's

estimates of the needs of the preference customers was only made through June 30, 1985. FERC held that the 1960-61 contracts with the private utilities were void and ordered PASNY to make available to the preference customers the full 50% share of Project power.

On rehearing, the Commission substantially modified its earlier opinion. While still finding that PASNY had not made a reasonable estimate in 1960-61 as to the load growth of the preference customers, the Commission found that the record contained evidence to show what a reasonable estimate would have been and that PASNY would be able to supply that estimated amount (albeit less than the full 50% amount claimed by the preference customers) from both the Niagara Power Project and the St. Lawrence Project through June 30, 1985. As of that date, FERC held, the contracts with the private utilities would become void and PASNY would then have to start providing 50% of the output of the Niagara project to the preference customers.

The Second Circuit upheld FERC's findings with respect to PASNY's obligations through June 30, 1985 but rejected the Commission's remedy for the period thereafter through 1989. It found that by requiring PASNY to supply the actual needs of the preference customers for that period (up to the 50% limit) rather than the lesser amount which the record showed would have been a reasonable estimate, the FERC had imposed an overly harsh remedy and would unjustly and unreasonably reward the preference customers.

In addition, the court rejected a claim by PASNY that the power to which the preference customers were entitled included only power for rural and domestic customers and did not include power resold to commercial and industrial customers. The court also rejected claims by the preference customers that the Commission's action on rehearing had been improperly influenced by certain *ex parte* Congressional communications objecting to the Commission's initial Opinion No. 151.

3. FERC Decisions Concerning Municipal Preference In Original Licensing Under the Federal Power Act

a. Abuse of Municipal Preference

In *Gregory Wilcox*, 24 FERC ¶ 61,317 (1983), *reconsid. denied*, 26 FERC ¶ 61,113 (1984), *reh'g. denied*, 27 FERC ¶ 61,403 (1984) the Commission held that it would not allow a non-municipality to gain the benefits of the municipal preference by coordinating the surrender of a municipal partner's permit with the filing of a non-municipal license application. In this series of decisions the Commission established a policy that where a non-municipal license application followed within 90 days the surrender by a municipality of a preliminary permit, the Commission would conduct an investigation as to whether such an applicant "abused" the municipal preference. In this instance, the Commission found such an abuse of discretion, dismissed the license application filed by the private entity and precluded all participants, including the municipality, from competing in any way for these project sites for one year.

In *Utah Board of Water Resources*, 27 FERC ¶ 61,437 (1984), municipal preference was challenged on the basis that the Utah Board of Water Resources

originally intended to lease the project to a cooperative that had not been included as a joint license applicant, and because another party, Sheep Creek Irrigation Company (SCIC) was to receive five percent of the gross revenues from the project in return for certain land and water rights.

The facts revealed that the Board intended to own and maintain all lands, water and facilities necessary for project operation and, further, that the Board intended only to enter into a contract with the cooperative whereby the cooperative would operate the project and purchase project power. In addition, it was found that SCIC would schedule water releases to maximize generation in exchange for five percent of gross revenues.

The Commission found that there were no facts showing that the Board was a "hybrid" and not entitled to a municipal preference. "Contracting with an entity to operate a project is common," said the Commission, and "does not give the operator any proprietary interest in the project." Furthermore, the Commission found that the payment of five percent of revenues to SCIC in exchange for its agreement to schedule water releases to maximize generation did not amount to an interest requiring a joint application.

In *Orofino Falls Hydro Limited Partnership*, 27 FERC ¶ 61,434 (1984), n. 10 (1984), the Commission described generally what a municipal preference permit holder could and could not do once it had determined not to go forward with the project. It may not retain the permit in order to convey a competitive advantage to any party interested in preparing a license application, nor may it in any other way assist a particular party. It may, however, offer for sale studies it has prepared, in order to recoup the cost of the studies.

In *Morgan City Corporation*, 28 FERC ¶ 61,157 (1984), the Commission held that preference had not been abused where a preference applicant bought a license application from a non-preference applicant, and agreed to transfer it back, contingent on a Commission finding that such transfer was not in violation of its policy on hybrid applications. The agreement would have constituted an abuse of preference but for the contingency clause. The Commission assumed the preference applicant was prepared to construct and finance the project itself.

b. Determination of Eligibility Of Governmental-Type Applicants for Municipal Preference

Allegheny Electric Cooperative Inc., 29 FERC ¶ 61,208 (1984), involved a mistake by the Commission in 1980, that led to a broad new policy statement by the Commission in 1984. In this case, the Commission set a policy that it will henceforth give written notice of a permit application "to any city, town, borough, township, or similar local political subdivision . . . in which any part of the project, and any federal facilities that would be used by the project, would be located."

By way of background, Allegheny Electric Cooperative Association, Inc. filed a permit application which was publicly noticed in 1980. Potter Township was not given written notice of that filing by the FERC. Five months after the deadline for filing competing applications for the project, and only a short time after Potter became aware of Allegheny's filing, Potter Township filed its permit application for the same site. In 1982, FERC granted a two year permit to Allegheny and rejected Potter's

application as late. In so doing FERC ruled that Potter was not entitled to notice of Allegheny's application under Section 4(f) of the Act because Potter was not a "municipality" within the meaning of Section 3(7). *Allegheny Electric Cooperative Inc.*, 20 FERC ¶ 61,049 (1982). The Commission order included an extended interpretation of what constituted adequate municipal "authority to engage in the business of developing, transmitting, utilizing or distributing power" under Section 3(7). FERC determined that Potter was not a "municipality" when Allegheny's application was noticed because, under state law, it could not "place water power to productive use."

Potter appealed the issue to the D.C. Circuit Court of Appeals. In the meantime, that same court decided *Northern Colorado Water Conservancy District v. FERC*, 730 F.2d 1509 (D.C. Cir. 1984). The court in *Northern Colorado* held that FERC erred when it refused to give Section 4(f) notice to special purpose political subdivisions. Shortly after Potter's appeal was filed, Allegheny filed a license application for the site, in reliance on the permit issued to it.

Following Potter's opening brief to the D.C. Circuit, FERC requested the court to remand the case, confessing error in its treatment of Potter. The court agreed to the remand. In the final *Potter* order on remand, FERC admitted its error, finding "no basis upon which to sustain [its earlier] order in this case." 29 FERC ¶ 61,208 (1984). It did not, however, agree that Potter was a municipality within the meaning of Section 3(7) at the time the notice of Allegheny's application was issued. Instead, FERC bypassed that issue by deciding that a "municipality" for purposes of Section 4(f) notice need not be a "municipality" for Section 3(7) purposes. The Commission said that, as a practical matter, it will not expend scarce agency resources to determine — at the permit notice stage — whether all potentially interested political subdivisions are competent municipalities within the meaning of Section 3(7). As FERC's new policy statement suggests, notice will be given to all local political subdivisions, without regard to their Section 3(7) status.

In addition, the Commission considered its proposed regulations that would require permit applicants to list in their applications certain local public bodies that would be interested in or affected by the proposed project. 49 *Fed. Reg.* 8009 (proposed March 5, 1984) (see discussion, *infra*). This new rule, along with FERC's broad Section 4(f) notice policy announced in *Potter*, should help the Commission prevent further cases like Potter — where a complainant finally gains acceptance of its permit application after its competitor has already filed a license application. FERC's solution in this case was to allow Potter, which now unequivocally has authority under Pennsylvania law to develop the project, additional time to put together a competing license application.

c. Municipal License/Private Financing Transactions In Which No License Transfer And No Abuse Was Found

El Dorado Irrigation District and El Dorado County Water Agency, 29 FERC ¶ 61,375 (1984). This holding represents the first FERC-approved private financing of a project licensed to a municipality since the *City of Fayetteville Public Works Commission* holding in 1981, 16 FERC ¶ 61,209 (1981). This case demonstrates that private financing of a municipal license applicant's project need not constitute an abuse of

municipal preference or create a "hybrid" applicant. It may also indicate that private financing of a municipally-licensed but unconstructed project will not necessarily constitute a "transfer" of the license to a non-municipal or hybrid entity.

The El Dorado Irrigation District (EID) and El Dorado County Water Agency (ECWA), "municipalities" under the Federal Power Act, held the preliminary permit for project No. 2761-000 and filed a license for the project in 1979. There were no competing license applicants. Prior to an FERC decision on the license, it became more economical to finance the project with private capital rather than with taxable municipal revenue bonds, as had been expected to be the case (tax-exempt municipal revenue bond financing was apparently not available to the applicants).

The municipal license applicants were able to distinguish the facts of their situation from the Commission's holding in *City of Vidalia*, 28 FERC ¶ 61,328 (1984), discussed *infra*, on the specific facts, as follows. The capital for construction of the project will come from a private investment group pursuant to a 40-year agreement with the licensees. The agreement contemplates that the investor group will borrow approximately 64% of the total construction cost at an interest rate of 14% with the remaining 36% being provided by contributions to equity by investors in exchange for income and future tax benefits. Revenues from the power sales contract and payments therefrom will be handled by a trustee or fiscal agent which will disburse the funds in conformance with agreements between the licensees, the private investor group and the private utility. Disbursements will be paid in the following order: First to project operation and maintenance; then to the private investor group for payment on the debt portion of the project cost; then to the licensees at a rate of 4 mills/kwh escalated payment; finally, balance remaining will be paid to the equity investors. The licensees will hold fee title to all project works and the Commission satisfied itself that the licensees would hold or control all necessary proprietary interests to carry out their responsibilities as licensees and to enable sufficient regulatory control by FERC.

The Commission's order issuing the license, dated December 31, 1984, evaluated and approved the financing arrangement as follows:

We have examined the proposed financing arrangements and find them acceptable. Although the license applicant is a municipality and the financing is being provided by non-municipal entities, this joint venture does not jeopardize the municipal status of the applicant. Consistent with our longstanding requirements in this regard, full ownership of project lands and facilities will rest in the named municipal licensee [citing *Fayetteville*]. The fact that non-municipal investors will receive a share of project revenues does not by itself create an impermissible hybrid venture.

B. License Transfers

1. Transfers Among Non-Municipal Entities To Facilitate Financing

During 1984 there were several Commission holdings dealing with the issue of license transfers. The cases involved transfers to obtain the most economical financing structure and tax ownership. As the Commission has stated, "a transfer for financing purposes is not *per se* objectionable." *John M. Jordan*, 27 FERC ¶ 61,435 (1984) at p. 61,807, citing *Paterson Municipal Utilities Authority*, 27 FERC ¶ 61,323 (1984) and *Boott Mills*, 25 FERC ¶ 61,386 (1983).

Fundamental legal issues involved in the license transfer cases include the requirement that a licensee hold the necessary proprietary interests required for all project purposes and the corollary that any entity that holds such proprietary interests be a named licensee or joint licensee. The earlier cases of *New York State Electric & Gas Corp.*, 16 FERC ¶ 61,176 (1981), *Niagara Mohawk Power Corp.*, 16 FERC ¶ 61,180 (1981), *City of Fayetteville Public Works Commission*, 16 FERC ¶ 61,209 (1981), and *Linweave Inc.*, 23 FERC ¶ 61,391 (1983), set the framework for the Commission's recent decisions.

In *Boott Mills*, the Commission approved a complicated future transfer arrangement between private parties in order to "facilitate financing and because the proposal satisfies our requirement that all entities who will have an ownership interest in the project property have been identified and included as joint licensees." 25 FERC at p. 61,849.

In *Little Falls Hydroelectric Associates*, 28 FERC ¶ 62,062 (1984), "in order to facilitate development and financing of the project," Little Falls Hydroelectric Associates, a general partnership, was authorized by the Commission to transfer its license to a limited partnership, consisting of three corporations and an individual limited partner. The limited partnership thus acted as the general partner.

2. License Transfers Involving Municipal Entities

When a municipal applicant or licensee is involved, a transfer becomes more complicated. In *Paterson Municipal Utilities Authority and Great Falls Hydroelectric Company*, 27 FERC ¶ 61,323 (1984), the Commission approved a "partial" transfer of the license held by a municipality, the Paterson Municipal Utilities Authority, to a new licensee made up of Paterson and the Great Falls Hydroelectric Company, a limited partnership. The purpose of the transfer was to enable a new project financing plan when Paterson was unsuccessful in its attempts to finance the project by the issuance of municipal bonds. Under the new financing plan, Paterson would continue to own the existing project works, including an existing dam and powerhouse, and would receive a significant share of gross project revenues. The limited partnership would own all of the new improvements at the site in order that its investors can claim tax benefits respecting those improvements.

The transfer applicants argued that there had been no "abuse" of municipal preference because, since there were no competitors, the preference was not used or invoked to obtain the license. However, the Commission repeated the view it had earlier expressed in its decisions in *Orofino Falls Hydro Limited Partnerships*, 26 FERC ¶ 61,245 (1984) and *Gregory Wilcox*, 26 FERC ¶ 61,113 (1984): "a municipal permittee or licensee is deemed to have employed municipal preference, whether or not competing applications were actually filed in response to its application for permit or license." 27 FERC at p. 61,609.

The Commission repeated its prior warnings in *Fayetteville* that where a municipal license applicant files for and subsequently receives a license, it is expected to hold all property and other rights necessary for project purposes. *Fayetteville*, said the Commission, "put all existing or potential applicants and permittees on notice of the consequences of their pursuing applications as municipalities, hybrids, or non-municipal entities," and "[h]aving put them on

notice, we will not allow that policy to be circumvented by . . . the transfer of a license." 27 FERC at p. 61,609. "[W]e must . . . protect the public interest in the integrity of our licensing process by ensuring that a municipal licensee who proposes a license transfer has pursued development of its proposed project in good faith and has not merely obtained a license to then barter it away to the highest bidder." *Id.* at p. 61,610.

The Commission nevertheless approved the transfer requested by Paterson because Paterson had filed and obtained its license prior to the Commission's warnings set forth in *Fayetteville*. The Commission also noted that Paterson had made diligent efforts to finance its project prior to soliciting proposals from private developers, had spent more than a half million dollars in pursuit of the license, and would retain substantial control over and ownership interest in the joint development.

In *City of Vidalia, Louisiana*, 28 FERC ¶ 61,328 (1984) the Commission denied the application for transfer by the municipal licensee, City of Vidalia, to the joint possession of the City and a limited partnership, Catalyst Old River Hydroelectric Limited Partnership ("Catalyst").

The City of Vidalia was issued a license for its project in January of 1982, four months after the Commission's decision in the *Fayetteville* case. When Vidalia's subsequent efforts to sell municipal bonds failed, it sought a private financing partner. Under the proposed financing arrangement, Vidalia would continue to own the project site and any other real estate associated with the project, would operate the project, receive annual payments, and ultimately gain full title to the project. Catalyst would own all improvements of the site in order to claim various tax benefits. Vidalia argued that it had spent several hundred thousand dollars, had been diligent in its pursuit of the license and that when it obtained its license it was unaware of any private party that may have been interested in the site but was deterred from applying because of the preference.

Said the Commission: "The central question is whether the integrity of our competitive licensing procedures, including municipal preference under Section 7(a) of the Act (16 U.S.C. § 800(a)), is compromised when a municipality obtains a license and subsequently proposes to transfer it in whole or in part to a non-municipal entity" (footnote omitted), 28 FERC at p. 61,608. The Commission repeated its prior warnings in *Fayetteville* and distinguished *Vidalia* from its holding in *Paterson*. The Commission held that because the Vidalia license was issued four months *after* the *Fayetteville* decision, Vidalia "must be held to the strict accounting called for by the Commission's policy to preserve the integrity of municipal preference . . ." outlined in its previous decisions. 28 FERC at p. 61,609.

The Commission consequently set up a "competitive transfer proceeding" whereby it would issue public notice of the proposed transfer and solicit competing applications from anyone wishing to become the transferee.

II. FERC PRE-EMPTIVE JURISDICTION

A. Congressional Proposals To Increase State Involvement In Licensing

As state consciousness has increased concerning the explosion of hydroelectric development along many of the nation's rivers and other waterways, state

frustrations about the inability to control such developments has also increased. Two methods of increasing such state involvement were introduced in the 98th Congress.

S. 2361, introduced by Senator Mitchell of Maine, would have amended Section 10(a) of the Federal Power Act to authorize states to adopt comprehensive plans for the development and use of rivers within their boundaries. If FERC approved any state plan, it would thereafter be bound by that plan in carrying out its hydroelectric licensing obligations. The bill was referred to the Senate Energy and Natural Resources Committee, but no action was taken.

H.R. 6198 introduced by Representative Jeffords of Vermont would have required FERC to delegate to any requesting state the authority to license hydroelectric projects at existing dams with an installed capacity of 30 MW or less. The bill was referred to the House Energy and Commerce Committee, but no action was taken on the bill.

B. Role Of Other Federal Agencies

1. New Agency Rules – Proposed United States Forest Service Policy On Special Use Permit Fees For Small Hydroelectric Projects

The United States Forest Service (“USFS”) published a proposed rule for special use permit fees for small hydroelectric projects in June, 1984. 49 *Fed. Reg.* 23,902 (proposed June 8, 1984). Comments were filed in August. No final action has been taken.

The proposed fees would apply to both exempted and licensed projects. During the investigation stage, USFS would charge \$200 annually for a permit. During the construction phase the rate would be 10% of the zone average land value of the acreage involved in construction. The USFS theory was that USFS should receive a return of about 10% a year on use of its land. The percentage would be revised every five years.

During operation, USFS would charge 3% of gross sales, which USFS estimated to be the fee paid to private landowners for use of land for small hydro projects. For projects where the power would be used directly, USFS would charge 3% of the average rate charged by local power companies for similar power usage.

2. Relationship Between FERC And The Department of the Interior

a. Escondido

Relying on Section 4(e) of the Federal Power Act, 16 U.S.C. § 797(e), the Supreme Court ruled in *Escondido Mutual Water Co. v. La Jolla et al. Bands of Mission Indians*, ____ U.S. ____, 104 S. Ct. 2105 (1984), that the Commission must include in any license all conditions which the Secretary of the Interior deems necessary for the protection and utilization of Indian reservations on which project works are located. The Court rejected arguments by the Commission that unfettered authority in the Department of the Interior is inconsistent with the legislative history or would interfere with other portions of the statutory scheme, such as the

Commission's exclusive authority to issue licenses. The courts of appeals, and not the Commission, will have to determine whether conditions imposed by the Department of the Interior are valid.

The court also held that the Commission need not accept conditions proposed by the Department of the Interior relating to reservations on which no licensed facilities were located, but which might be affected by a licensed project. Finally, the Court determined that Section 8 of the Mission Indian Relief Act, 26 Stat. 714, does not require that a licensee obtain the consent of the Indian Bands before it operates facilities located on reservation lands.

b. Effect Of Wild And Scenic Rivers Act

In *Town of Summersville, West Virginia, et al.*, 27 FERC ¶ 61,206 (1984), the Town of Summersville and Southeastern Renewable Resources, Inc. had filed competing license applications for a project to be located at a Corps of Engineers' dam on the Gauley River in West Virginia. In its comments on the proposed project, the Department of the Interior argued that the Commission lacked jurisdiction to license the project because the stretch of river immediately below the dam had been authorized by Congress, under Pub. L. No. 95-625, § 1108, 92 Stat. 3547 (1978), for study as a potential component of the National Wild and Scenic Rivers System. The Commission agreed that it could not issue a license after finding that the stretch of the Gauley River was under study.

c. Federal Government Development Versus FERC-Licensed Private Development

In *City of Redding, California*, 28 FERC ¶ 61,342 (1984) the Commission refused to accept a preliminary permit for a dam where Congress had authorized a certain level of power production by a Bureau of Reclamation Project. Until the Bureau of Reclamation decided how to implement its authorization, no other party could apply for authorization under the Federal Power Act to develop any remaining potential.

III. THE LICENSING PROCESS

A. Reorganization of FERC

FERC Chairman O'Connor on June 28, 1984 announced an internal reorganization effective July 15, 1984, that affected hydro staff. A new Office of Hydropower Licensing was spun off from the existing Office of Electric Power Regulation. Chairman O'Connor stated that hydro licensing was a processing and production function and required a different type of attention from the economic issues deliberative process involved in electric rate cases.

B. Hydro Authorization Procedures Rulemaking Proposal

On February 24, 1984 FERC issued a Notice of Proposed Rulemaking, FERC Docket No. RM83-56, 49 *Fed. Reg.* 8009 (proposed March 5, 1984), contemplating

major revisions to the Commission's rules governing hydroelectric project license and exemption application procedures. As issued, the proposed regulations would substantially reorganize Part 4 of the Commission's regulations, 18 C.F.R. Part 4, and include a number of important substantive changes, most significantly affecting the pre-application consultation process and the general circumstances of competition for hydro licenses and exemptions. In large part, the reorganization of Part 4 was necessitated by new licensing exemption provisions which during the previous three years have increased hydroelectric applications to record levels.

With regard to pre-application consultation with federal and state agencies having jurisdiction over project lands, the proposed rules include a new Section 4.38 which prescribes a three-stage pre-application consultative process. In an effort to insure that applications filed with the Commission do not require the extensive post-application consultation that has become common, the proposed rules specifically contemplate that the pre-application consultation must go beyond mere information sharing and that areas of dispute between applicants and agencies must be identified, the applicant must perform reasonable studies necessary to assess potential impacts on the environment, and the applicant must attempt to resolve remaining disputes with these agencies.

The proposed rulemaking solicits comments and suggestions with respect to the formulation of generic guidelines applicable to so-called hybrid applications filed jointly by private developers and municipalities. As discussed *supra* Section I, since the issuance of *Fayetteville*, the Commission has had to determine, on a case by case basis, whether particular contractual relationships between a municipal applicant and private interests are permissible, thus giving rise to the problem of discerning "hidden hybrid" arrangements which are not legally entitled to municipal preference. Although the Commission has so far declined to investigate allegations of hidden hybrids at the permit application stage, the preamble to the proposed rules explicitly reserves that option for the future. Moreover, in further recognition of the need to police the application of the municipal preference, the proposed rules require applicants to state in their application whether they claim municipal preference. See proposed sections 4.41(a)(4); 4.51(a)(4); 4.61(5); 4.71(a)(5); and 4.81(a)(4).

Additional provisions in the proposed rulemaking would have allowed license and exemption applications to be filed in competition with a preliminary permit application at any time before the permit is issued; would specify the criteria for evaluation of competing exemption applications; and would remove the 7.5 Mw minimum capacity requirement required for license applicants seeking to compete with an initial exemption application.

FERC received a predictably substantial volume of comments in response to the proposed rulemaking from diverse interests and expressing widely divergent views, especially on matters relating to the municipal preference provisions and pre-application consultation requirements. Although the Semi-annual Regulatory Agenda published in the *Federal Register* on October 22, 1984, 49 *Fed. Reg.* 42419, indicated a December 31, 1984 target date for promulgation of the final rules, no final rulemaking was promulgated by that date. Commission action on final rules was expected in early 1985.

C. *No Need For Hearing On License Applications*

A federal appellate court ruled that the Commission need not hold a trial-type evidentiary hearing in a situation where the petitioner had ample opportunity to present evidence to the Commission and had failed to explain how a trial-type hearing with cross-examination would have produced a fuller and truer disclosure of the facts. The petitioner had failed to identify disputed material facts. *Sierra Association for Environment v. F.E.R.C.*, 744 F.2d 661 (9th Cir. 1984). The petitioner had relied on Section 308 of the Federal Power Act, 16 U.S.C. § 825g, and the Administrative Procedure Act, 5 U.S.C. § 554.

D. *Need For Environment Impact Statement In Relicensing*

In *Confederated Tribes and Bands of the Yakima Indian Nation v. FERC*, 746 F.2d 466 (9th Cir. 1984)¹ the Court determined that the Commission erred in relicensing the Rock Island Project on the Columbia River without first considering fishery issues and without having issued an Environmental Impact Statement.

In 1980, the Commission had approved a five-year study of fish protection measures at a number of dams on the Columbia River in the so-called *Mid-Columbia* proceeding. In relicensing the Rock Island Project, the Commission assumed that fish protection measures could be imposed at the conclusion of the *Mid-Columbia* proceeding as a result of a "reopener" clause contained in the new license. That was not sufficient. "Prior to issuance of a new license, FERC must study the effect of a project on the fishery resource and consider possible mitigative measures." If the five year study had to be completed, annual licenses should have been issued.

The Court also found that the Commission had improperly (1) failed to require the filing of an Exhibit S, a report on the projected effect of the dam on fish and wildlife resources and (2) failed to consult with fishery agencies and Indian tribes prior to license issuance.

Finally, the Court determined that an Environmental Impact Statement must be prepared to assist the Commission in determining what conditions to attach to a new license, as well as whether a non-power license is more appropriate than relicensing of a power project. FERC's argument that no EIS was necessary because there was no change in the status quo was rejected. The Court's discussion of the need for an EIS is not specifically related to the fishery issues under consideration.

E. *License Conditions*

1. *Sensual, Recreational And Indian Values*

In *Northern Lights, Inc.*, 27 FERC ¶ 63,024 (1984), an Administrative Law Judge denied a license for a project on the grounds that "unique disadvantages" flowing from construction of the Kootenai Project outweigh any need for the project. More specifically, the judge found the "changes in the sensual and recreational values that

¹The Opinion reported at 734 F.2d 1347 (9th Cir. 1984) was withdrawn and an amended opinion was issued October 30, 1984.

would be caused to the Kootenai Falls by the project” together with the “adverse effect the Project would have on the Kootenai Indians” are determinative in light of a lack of a clear showing of the need for the project.

2. Access Fees for Recreational Use

In response to a complaint from a commercial rafting outfitter, the Commission confirmed that Central Maine Power Co. could collect fees to defray the cost of providing facilities for the rafters, but that the fees must be limited to the costs of those facilities. *Central Maine Power Co.*, 28 FERC ¶ 61,246 (1984). Fees cannot exceed costs specifically incurred for the rafters and may not include basic project development costs such as return on investment in non-recreational facilities or fees for managing the flow of the river.

F. License Fees

1. Annual Charges

a. Congressional Developments

In response to the FERC's proposed rule for calculating annual charges for the use of government dams (*see infra*, Section F.1.,b) legislation was introduced in the 98th Congress to set a ceiling on annual charges. S. 1132, which passed the Senate in March, imposed a cap of \$1/kW per year as a capacity charge, plus ½ mill/kWh per year as an energy charge. After the FERC responded through rulemaking with a formula for a graduated, fixed-fee scale, the House version of the annual charges bill, H.R. 3660, reflected the FERC final formula, and thus differed from the Senate bill. H.R. 3660 was approved in committee but did not reach the floor of the House for a vote. In all likelihood, legislation along the lines of H.R. 3660, reflecting the FERC final rule, will be introduced early in the 99th Congress.

b. FERC Annual Charges Rulemaking

The FERC issued a proposed rulemaking on annual charges for the use of government dams on March 31, 1983, 48 *Fed. Reg.* 15,134 (proposed March 31, 1983) (FERC Docket No. RM83-13). The original proposed rule would have set annual charges based on the value of power generated at the government dam, using a formula for power value developed for an entire region. The licensee would have had to pay 50% of the net benefits calculated by this method. The amount due would have increased annually as power output increased; and would have been adjusted for inflation. The comments received in response to the proposed rule were generally critical, and as noted above the Senate had already passed its own version of a flat rate cap on annual charges.

In its final rule, issued May 24, 1984, 49 *Fed. Reg.* 22,770 (1984), FERC abandoned its proposed method in favor of a graduated flat rate based on the amount of energy produced. The final rule provides a simple, lower cost, and more predictable calculation of annual charges. The Commission will charge 1 mill per

kWh for the first 40 gigawatt hours of energy; 1½ mills per kWh for the next 40 gigawatt hours; and 2 mills per kWh for all energy over 80 gigawatt hours. These charges may be readjusted twenty years after issuance of the license and every ten years thereafter. They are not indexed to inflation.

Case-by-case adjustment of annual charges may be possible where a prospective licensee agreed separately at an earlier time to share in the cost of construction of the dam, *e.g.*, for irrigation purposes. The Commission rejected any special treatment for small hydro projects, stating that the graduated rate schedule adequately takes account of the public policy of encouraging small hydro development.

The final rule went into effect August 15, 1984 for all projects licensed in 1979 and thereafter at government dams, and for readjustment of annual charges at such dams. Information requirements went into effect in November, 1984.

The Commission granted rehearing in part on August 23, 1984, 28 FERC ¶ 61,266 (1984), by adding a section providing procedures for obtaining waiver for contractual payments. It denied rehearing on other issues. Because legislation on annual charges was not enacted, see *supra*, this rule now governs the level of annual charges for the use of government dams.

2. FERC Headwater Benefits Rulemaking

In late 1983 the FERC issued a proposed rule covering payments for benefits from headwater improvements. 49 *Fed. Reg.* 1067 (proposed June 9, 1984). Comments were due in March, 1984. No final rule has been issued.

The proposed rule sets out a general formula that apportions among the headwater project and downstream projects the costs of the upstream facility related to headwater benefits. The costs would be shared based on the relative amount of energy produced at the headwater project and the amount of energy gains produced at downstream projects. Language in the proposed rule suggests that the apportionment formula would use an average annual energy figure, instead of recalculating the payment each year; but this is not altogether clear.

Where annual charges for use of a government dam are also assessed, they would be reduced by the amount of any headwater benefits for years in which both charges are assessed. The regulation also provides for billing procedures. The new rule would apply to all river basins and all time periods except where final headwater benefits have already been set by Commission order (a number of orders have established only interim benefits.)

IV. EXEMPTIONS

A. *Impact of Other Agencies*

The Commission denied an exemption application, based on the recommendation of the United States Fish and Wildlife Service. *Douglas Water Power Company*, 26 FERC ¶ 61,409 (1984). The applicant subsequently appealed this order, asserting that the deficiency letter of the Deputy Director, Office of Electric Power Regulation, was overly vague, and was granted an additional thirty days to supply

the information later identified by the Deputy Director with greater particularity. *Douglas Water Power Company*, 27 FERC ¶ 61,276 (1984).

B. Statutory Criteria for Exemption Eligibility

In *Tulalip Tribes of Washington Inc. v. FERC*, 732 F.2d 1451 (9th Cir. 1984), the Ninth Circuit invalidated the Commission's final rule authorizing case-specific exemptions from federal licensing requirements for small hydroelectric projects that use "diversion structures" no taller than ten feet and impound no more than two acre-feet of water. At the time of the decision, 128 of the 167 projects approved by the FERC under the so-called natural water feature exemption (including over thirty projects under construction and over twenty projects on which construction had been completed) involved such man-made "diversion structures." The Commission immediately was faced with the need to determine how to apply the mandate of the Ninth Circuit to such projects.

In its opinion in *Tulalip*, the Ninth Circuit found that the diversion structures included within the scope of the Commission's final rule on exempt hydroelectric projects went beyond the Commission's lawful authority pursuant to the Public Utility Regulatory Policies Act of 1978 ("PURPA"), as amended by the Energy Security Act of 1980 ("ESA"), 16 U.S.C. §§ 2705, 2708(b). Under PURPA, the FERC is authorized to exempt from licensing "any project which utilizes or proposes to utilize natural water features for the generation of electricity, *without the need for any dam or impoundment . . .*" 16 U.S.C. § 2708(b) (emphasis added). The *Tulalip* court found that the Commission's regulations governing the natural water feature exemption not only violated the plain meaning of 16 U.S.C. § 2708(b), but also ran afoul of PURPA's explicit command that "Nothing in this chapter authorizes . . . the simple and expeditious licensing of any such new dam or other impoundment." 16 U.S.C. § 2706.

In the wake of the *Tulalip* decision, the Commission was required to determine how and whether to apply the Ninth Circuit's more restrictive approach to the natural water feature exemption retrospectively to the 128 projects which included man-made diversion structures of the character that the *Tulalip* court found beyond the statutory scope of this exemption. On July 18, 1984, the Commission issued a series of decisions dealing with the application of the *Tulalip* decision to these projects. *Eagle Power Co.*, 28 FERC ¶ 61,061 (1984); *Snowbird Ltd.*, 28 FERC ¶ 61,062 (1984); *Forward Power and Energy Co.*, 28 FERC ¶ 61,063 (1984); *Pigeon Cove Power Co.*, 28 FERC ¶ 61,064 (1984); *City of Seattle, Washington*, 28 FERC ¶ 61,065 (1984).

In *Eagle Power*, the Commission chose the route of limited retroactivity to projects on which construction had commenced. The Commission concluded in *Eagle Power* that the criteria used by the Supreme Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), should govern the retrospective application of the *Tulalip* decision. In *Chevron*, the Supreme Court approved the use of the following three tests for use in determining whether a judicial decision should be applied retroactively:

- (1) Whether the judicial decision establishes a new principle of law, either by overruling clear past precedent upon which litigants have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed;

- (2) Whether retroactive application would further or retard the purposes of the rule in question; and
- (3) Whether retroactive application of the new rule would be inequitable. 404 U.S. at 106-107.

Applying these factors to the natural water feature exemption cases at bar, the Commission in *Eagle Power* chose to distinguish those projects on which physical construction activity was in process (or had been completed) on or before May 10, 1984 (the date of the *Tulalip* decision) from projects which remained in the Commission processing stage. Applying the *Chevron* analysis, the Commission found that a policy of limited retroactivity was appropriate because (i) the *Tulalip* decision decided an issue of first impression whose resolution was not clearly foreshadowed; (ii) retroactive application of *Tulalip* would frustrate PURPA's objective of promoting expeditious development of small hydroelectric facilities, and (iii) requiring hydro developers with previously exempted projects under construction to apply for licenses would cause further delay and impose an unfair economic burden. The Commission thus decided not to require developers of projects under an exemption to reapply for a license.

With respect to previously exempted projects on which physical construction had not begun by May 10, 1984, the Commission determined that the *Tulalip* court's more restrictive view of the natural water feature exemption should be applied. Exemption holders for such projects were to be given the opportunity either to conform their projects to the requirements in *Tulalip* or to apply for a project license. In order to promote fair and expeditious processing of these applications, however, the Commission in *Eagle Power* established procedures for hydro developers whose exemptions were vacated to file a streamlined application for license, and gave such developers 120 days to submit such applications while retaining their original filing date.

Respectfully submitted,

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