

# PAYING FOR THE CHANGE: CAN THE FERC FORCE DAM DECOMMISSIONING AT RELICENSING?

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[A] strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change.<sup>1</sup>

## I. INTRODUCTION

Hydroelectric dam decommissioning has become a *cause celebre* among environmental advocates.<sup>2</sup> Secretary of the Interior Bruce Babbitt delighted the attendees at a 1994 Symposium organized by Trout Unlimited by saying: "I would love to be the first secretary of the interior in history to tear down a really large dam."<sup>3</sup>

The Federal Energy Regulatory Commission (FERC or Commission) has responded favorably to the river restoration movement. In its December 14, 1994 Policy Statement on Project Decommissioning at Relicensing, the FERC asserted, for the first time,<sup>4</sup> that it has legal authority under the Federal Power Act (FPA) to order project decommissioning at the expense of the licensee when a hydropower license expires.<sup>5</sup> The FERC qualified its Policy Statement by opining that "where existing projects are involved, license denial would rarely occur."<sup>6</sup> At the same time, the Commission indicated that decommissioning may result from its imposition of conditions at relicensing which render "an already marginal project . . . uneconomic."<sup>7</sup> The Commission somewhat ominously concluded that "this

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1. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 416 (1922).

2. See Michael T. Pyle, *Beyond Fish Ladders: Dam Removal as a Strategy for Restoring America's Rivers*, 14 *STAN. ENVTL. L.J.* 97 (1995).

3. Jeannine Anderson, *Endangered*, *PUB. POWER*, Jan./Feb. 1995, at 34, 36.

4. The Commission had issued a Notice of Inquiry the previous year in which it had asked for public comment on the issue of its decommissioning authority. Notice of Inquiry-Project Decommissioning at Relicensing, 58 *Fed. Reg.* 48,991 (1993).

5. Policy Statement-Project Decommissioning at Relicensing, 60 *Fed. Reg.* 339 (1995) [hereinafter Policy Statement]. Commissioner Bailey dissented from the Commission's decision. *Id.* at 355.

6. *Id.* at 340.

7. *Id.*

possibility will not preclude it from imposing the environmental (and other) conditions it deems appropriate . . . ."<sup>8</sup>

The consequences of the FERC's decommissioning Policy Statement are potentially enormous because hundreds of hydroelectric licensees are presently in relicensing proceedings or nearing the end of their license terms.<sup>9</sup> The Policy Statement also comes at a time of increasing instability and competition in the electric industry generally.<sup>10</sup>

The FERC's approach to decommissioning at relicensing raises some controversial and novel questions regarding the impact of decommissioning on the property interests of the hydropower licensees affected. This article examines those questions. It is divided into four parts. The first part addresses the FERC's decommissioning authority under the FPA. The second part explores whether forcing an uncompensated dam decommissioning on a licensee constitutes a breach of contract by the FERC. The third part discusses Fifth Amendment takings jurisprudence and the circumstances under which the decommissioning of hydroelectric projects at license renewal might constitute a "regulatory taking." The fourth part provides an overview of private property rights legislation introduced in the 104th Congress and discusses the application of that legislation to hydroelectric decommissioning. The article concludes that: (1) the FERC lacks statutory authority to order project decommissioning; (2) forced project decommissioning at relicensing violates the contractual rights and expectations of licensees; (3) in certain circumstances, implementation of the FERC's Policy Statement may result in a taking requiring compensation under the Fifth Amendment; and (4) proposed legislation in the 104th Congress would force the FERC to examine the takings implications of its decommissioning policy and could make it easier for licensees to obtain compensation for decommissionings on takings grounds.

## II. DOES THE FERC HAVE DECOMMISSIONING AUTHORITY?

Sections 14 and 15 of the FPA set forth four options available to the government when a hydropower license expires: (1) the United States may take over the project, including payment to the licensee of either its "net investment" in the project (not to exceed "fair value")<sup>11</sup> or fair market value, depending on whether the existing licensee is a private company, or

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8. *Id.*

9. 1994-95 Relicensing Report, Hydrowire (1994). The Commission has noted that "relicensing activities will constitute a large element of the Commission's future hydropower agenda." 1988 F.E.R.C. Ann. Rep. at 20-32.

10. See Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 60 Fed. Reg. 17,662 (1995) (to be codified at 18 C.F.R. pt. 35).

11. 16 U.S.C. § 807 (1994). Net investment is defined in excruciating and arcane detail in section 3(13) of the FPA, 16 U.S.C. § 796(13) (1994), but essentially means the original project cost, plus improvements, minus depreciation. See *Pacific Gas and Elec. Co.*, 40 F.E.R.C. ¶ 61,218, at 61,740 (1987).

state or municipal entity;<sup>12</sup> (2) the FERC may issue a new license to the existing licensee “upon reasonable terms;”<sup>13</sup> (3) the FERC may issue a new license to a new licensee “upon reasonable terms,” including payment to the existing licensee of its net investment or fair market value as the case may be; or (4) the FERC may license all or part of the project for “nonpower use.”<sup>14</sup> The nonpower license is to be a “temporary” license<sup>15</sup> pending transfer of regulatory supervision to another governmental entity. A nonpower licensee must pay net investment to the existing licensee to take over the project.<sup>16</sup>

If the status of the project remains unresolved at license expiration, FPA section 15 directs the FERC to issue an “annual license” to the existing licensee under the same terms and conditions as the existing license.<sup>17</sup> This effectively extends the existing license from year to year until final project disposition.

In its Policy Statement, the FERC claims authority to exercise two additional options at license expiration. First, the FERC asserts that it may *deny* a license at renewal. This would occur if the Commission concludes that “even with ample use of its conditioning authority, a license still cannot be fashioned that will comport with” the FERC’s obligation to balance power and nonpower values under the FPA.<sup>18</sup> The FERC would then order decommissioning. Second, the Policy Statement contemplates decommissioning if the FERC issues a license with environmental conditions which render a project economically infeasible. In such instances, the “licensee may prefer to take the project out of business, because the costs of doing business have become too high.”<sup>19</sup> Decommissioning may range from an order that a project’s power be shut off, to a requirement that the

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12. In 1953, Congress amended the FPA to exempt state and municipal licensees from the “net investment” provisions of section 14. *Id.* § 828b. The purpose of this amendment was to assure municipalities (and investors in municipal bonds) that the net investment reimbursement formula would not apply, and that the United States would have to condemn municipal projects at full fair market value even at license expiration. S. REP. NO. 599, 83d Cong., 1st Sess. (1953), *reprinted in* 1953 U.S.C.A.N. 2401, 2402. Section 14 of the FPA reserves the right of the federal government or any state or municipality to acquire a project at any time during the license term by condemnation and payment of just compensation. 16 U.S.C. § 807(a) (1994).

13. 16 U.S.C. § 808(a)(1) (1994).

14. 16 U.S.C. § 808(f) (1994).

15. *Id.* § 808(f).

16. *Id.*

17. *Id.* § 808(a)(1).

18. Policy Statement, *supra* note 5, at 340. The FPA requires that, when making licensing decisions, the Commission give “equal consideration” to “power and development purposes . . . energy conservation, the protection, mitigation of damage to, and enhancement of, fish and wildlife . . . the protection of recreational opportunities, and the preservation of other aspects of environmental quality.” FPA § 4(e), 16 U.S.C. § 797 (1994). The FPA further provides that the FERC must condition licenses upon appropriate measures to protect, mitigate damage to, and enhance fish and wildlife, and that the project as licensed shall be “best adapted to a comprehensive plan” for the waterway, taking into account the needs of power development, fish and wildlife, irrigation, flood control, water supply, recreation, and other competing uses. FPA § 10(a), (j), 16 U.S.C. § 803(a), (j) (1994).

19. Policy Statement, *supra* note 5, at 343.

dam and project works be removed and the project area be restored by the licensee to pre-project environmental conditions.<sup>20</sup>

The Commission acknowledges that the FPA does not expressly address decommissioning. The FERC, however, asserts its authority "to fill in gaps left by the statute."<sup>21</sup> The principal gap the Commission finds is a potential conflict between section 15, which does not identify license denial or decommissioning as among the FERC's choices at license expiration, and the Commission's obligation to re-evaluate and balance competing water uses under section 10(a).<sup>22</sup> The hydroelectric industry argued that this conflict is a chimera because section 15's requirement that new licenses be issued "upon reasonable terms" precludes the FERC from either forcing decommissioning or attaching conditions that make licenses uneconomic. The FERC rejected this argument. The Commission held that adopting the industry's reasoning "would mean that severe environmental damage would have to be accepted in order to protect even a very marginal hydro-power project."<sup>23</sup> The Commission did not explain how continuing the operation of projects that have been in place 50 or more years and have long ago permanently altered the environment could result in "severe environmental damage."<sup>24</sup>

Furthermore, the FERC appears to have lost sight of the principal issue in the debate over its decommissioning authority. That issue is not whether continued operation of a project is in the public interest, but rather *who pays* if the public interest dictates that it be removed.<sup>25</sup> The FPA's answer is plain: the federal government must pay to clear the stream if changing public values demand that a privately owned project be taken over and converted to nonpower uses.<sup>26</sup> The measure of compensation is to be "net investment," unless the project is municipally owned, in which case it is "just compensation." Although the FERC can recommend decommissioning,<sup>27</sup> Congress must make the final decision and appropriate the funds to acquire the project. The FERC, however, sidesteps this issue in the Policy Statement by interpreting section 14's takeover provisions to

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20. Policy Statement, *supra* note 5, at 343.

21. Policy Statement, *supra* note 5, at 340.

22. Policy Statement, *supra* note 5, at 341.

23. Policy Statement, *supra* note 5, at 343.

24. The Ninth Circuit, in *Confederated Tribes and Bands of the Yakima Indian Nation v. FERC*, 746 F.2d 466 (9th Cir. 1984), held that the FERC is required to conduct a new environmental review at license renewal. However, the FERC has determined that the appropriate environmental "baseline" for determining relicensing impacts and mitigation measures is the current condition of the site, not pre-project conditions. *City of Tacoma*, 67 F.E.R.C. ¶ 61,152, at 61,443-44 (1994), *reh'g denied*, 71 F.E.R.C. ¶ 61,381 (1995), *appeal dismissed for lack of jurisdiction*, No. 95-70645 (9th Cir. Jan. 29, 1996).

25. Commissioner Bailey, in her dissent, pointed out that the practical consequence of forced decommissioning of utility-owned projects is to shift costs from the public to rate payers of the affected electric utility. Policy Statement, *supra* note 5, at 355-56.

26. In this respect, the decommissioning of hydroelectric projects differs from the decommissioning of nuclear plants. In contrast to the FPA, the Atomic Energy Act expressly requires that utilities pay into a fund to be used to cover decommissioning costs. See 42 U.S.C. § 2297g-1(c) (1994).

27. See FPA § 7(c), 16 U.S.C. § 800 (1994).

apply only in a very narrow circumstance, *i.e.*, where the federal government intends to operate the project for *power* purposes.<sup>28</sup>

The legislative history of the FPA<sup>29</sup> strongly supports the view that Congress did not intend for the burden of dam removal or other significant decommissioning costs to be borne by project licensees. Conspicuously absent from the FPA legislative history is any indication that Congress was concerned about how much a former licensee would have to pay for dam removal, post-license environmental mitigation, or other economically significant expenditures. To the contrary, the focus of the debate was squarely upon what the *government* was obligated to pay the *licensee*.<sup>30</sup>

This intent is fully consistent with contemporaneous testimony offered during the congressional hearings predating passage of the FPA. In one such hearing, Mr. O. C. Merrill, Chief Engineer of the Forest Service (who was appointed the first Executive Secretary of the original Federal Power Commission in 1920), testifying on behalf of the Administration, confirmed the limited statutory options for treatment of projects upon expiration of a license:

These licenses will contain in specific terms all the conditions binding upon the licensee, will not be subject to revocation or change during the period of 50 years, but will terminate at the end of the 50 years. At the end of the 50 years three courses are open: The United States may buy out the properties of the licensee and thereafter maintain and operate the project for governmental purposes; or it may grant a license to somebody else on the condition that the new licensee buy out the properties of the original licensee; or it may grant a new license to the holder of the original license. The bill provides that at the end of the 50 years, any one of these three courses may be taken. If the properties are not taken over, either by the United States or by a new licensee, the original licensee shall have a second license, and after the termination of the second license a third license, and so on, indefinitely, each subsequent license to be issued for such period of time and under such conditions as the

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28. Policy Statement, *supra* note 5, at 343. This narrow interpretation of section 14 is belied by the testimony before Congress of the FERC's predecessor, the Federal Power Commission (FPC), in support of the 1968 amendments to the FPA. Those amendments changed the procedure by which the FPC (now the FERC) would recommend federal recapture of a project at relicensing, and also added the option for issuance of a temporary, nonpower license. In a letter to the Hon. John W. McCormack, speaker of the House of Representatives, the Chairman of the FPC, Lee W. White, described the FPC's choices upon license termination as including "recapture" not only where the United States has an interest in marketing the power, but "more probably out of other water use programs, such as irrigation, fish, recreation, pollution control or domestic and industrial use." Act of Aug. 3, 1968, Pub. L. No. 90-451, 1968 U.S.C.A.N. (82 Stat.) 3081, 3088.

29. The FPA's predecessor was the Federal Water Power Act of 1920, ch. 285, 41 Stat. 1063. Sections 14 and 15 were not significantly changed when the Act was amended in 1935 to become the FPA. 49 Stat. 844, 844-47 (1935).

30. For example, one congressional Representative stated:

So the question recurs as to what we are going to pay. A fair compensation of value or cost? The water-power people came before us and advocated cost. We changed it to fair compensation, for this reason: Nobody can tell what may happen at the end of 50 years. Some of these dams may not be worth blowing up, because of a change of business, change of navigation conditions, a change in the method of generating and transmitting power. The changes may be so startling that the public should not fairly take the risk. It is not asked to. If it should not take the risk, it ought not in fairness to have the increment.

51 CONG. REC. H12,700 (daily ed. July 24, 1914) (remarks of Rep. Stevens).

then existing law may prescribe. *That is, there is to be no time when a licensee shall not have either the right to get a new license under appropriate conditions, or the right to have his properties taken over.*<sup>31</sup>

The 1919 Senate Report illustrates Congress' explicit intent that the licensee's investment in a hydroelectric project be protected:

[The FPA] will be useless if capital will not invest under it. It will not do so unless it is reasonably certain of the return of its investment if the works are taken over . . . . The works must be continued in operation at the end of 50 years in order that the industries created by them and dependent upon them may not suffer. *Private capital should not be required to do this upon unreasonable terms nor should its property be confiscated.*<sup>32</sup>

So far, the FERC has not used its purported decommissioning authority to deny a license. However, it is now routinely using the costs of decommissioning to justify issuing new licenses with onerous environmental conditions which—but for the spectre of decommissioning costs—might lead licensees to reject the licenses. This is illustrated by the FERC's tendency to focus on decommissioning costs where its analysis indicates that the project, with environmental conditions, is uneconomic compared to the cost of alternative power—*i.e.*, where the licensee might otherwise be tempted to retire the project.<sup>33</sup> In essence, costs of decommissioning are used as a benchmark to determine how much of a premium above competitive power costs a licensee may be expected to absorb on a "lesser of two evils" theory. The FERC appears to be calculating that licensees will agree to operate their projects at a loss rather than risk incurring even greater costs through forced decommissioning. The threat of decommissioning is thus subtly invoked to leverage licensees into continuing to operate their projects for nonpower benefits such as recreation, fish and wildlife, and cultural programs.<sup>34</sup>

### III. FORCED DECOMMISSIONING AS A BREACH OF CONTRACT BY THE FEDERAL GOVERNMENT

Even if the FERC's Policy Statement were correct in its assertion of statutory decommissioning authority, licensees who received their licenses prior to the Policy Statement may be able to claim that a forced, uncompensated decommissioning by the FERC would be a breach of contract.

31. *Hydroelectric Project Relicensing, 1918: Hearings on S. 1419 Before the House Comm. on Water Power*, 65th Cong., 2d Sess. 25-26 (1918) (statement of Mr. Merrill, chief engineer of the Forest Service, who was appointed the first Executive Secretary of the original FPC in 1920) (emphasis added) [hereinafter *Water Power Hearings*]. For purposes of this analysis, S. 1419 was substantially similar to the Federal Water Power Act, ch. 285, 41 Stat. 1063 (1920).

32. S. REP. NO. 180, 66th Cong., 1st Sess. 2 (1919) (emphasis added).

33. See, e.g., *Duke Power Co.*, 72 F.E.R.C. ¶ 61,030, at 61,185-86 (1995); *Northern States Power Co.*, 72 F.E.R.C. ¶ 62,204 (1995); *Upper Peninsula Power Co.*, 72 F.E.R.C. ¶ 62,188 (1995); *Northern States Power Co.*, 72 F.E.R.C. ¶ 62,182, at 64,309. See also *supra* note 10.

34. Such leverage would not exist where the cost of operation exceeds the cost of decommissioning. See, e.g., *Wisconsin Elec. Power Co.*, 72 F.E.R.C. ¶ 62,190, at 64,514 (1995) (stating that the cost of continued operation, even without environmental enhancements, is more expensive than project retirement).

The crux of this argument is that an FPA license is a contract between the licensee and the Commission. When licenses now coming up for renewal were first issued, both parties to the contract expected and understood that upon license expiration the licensee would either: (1) receive a new license on reasonable terms; or (2) be compensated for his investment. The fact that the FERC has now proclaimed a new interpretation of the statute does not affect the original contractual intent, which remains binding upon it.

#### A. *Hydropower Licenses Are Contracts*

Congress' purpose in enacting the Federal Water Power Act (FWPA), currently Part I of the FPA, was to induce private investment by giving hydropower licensees contracts that secured the terms and conditions of operation. For example, in the Hearings on Water Power Legislation that preceded the passage of the FWPA, one of the principal proponents of the legislation noted, "The license is in the nature of a contract, and a contract could be modified at any time by agreement of the parties."<sup>35</sup> A congressional sponsor stated, "My idea would be that this contract—and this license is a contract—should be made for 50 years . . . ."<sup>36</sup>

To further its purpose of inducing licensees' reliance, Congress included contractual language in the statute, particularly in sections 6 and 28.<sup>37</sup> Section 6 demonstrates Congress' intent to create contractual expectations and induce reliance.<sup>38</sup> For example, section 6 provides that the terms and conditions of the license must be expressed in the license itself and that those terms and conditions may not be altered without "mutual agreement" between the licensee and the Commission. In addition, section 6 requires acceptance of the license by the licensee, and incorporates that acceptance into the license. These provisions in section 6 have been held to promote stability by protecting licensed projects against unilateral changes by the Commission that would alter the license or licensed project works.<sup>39</sup> In essence, section 6 reflects Congress' intent to create expectations in the

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35. *Water Power Hearings*, *supra* note 31, at 73 (remarks of Mr. Merrill, chief engineer of the Forest Service, who was appointed the first Executive Secretary of the original FPC in 1920). These Hearings were on water power legislation that was substantially similar to the Act that was reintroduced and passed the House and the Senate in 1920.

36. *Water Power Hearings*, *supra* note 31, at 465 (remarks of Iowa Rep. Haugen).

37. FPA §§ 6, 28, 16 U.S.C. §§ 799, 822 (1994).

38. Section 6 reads:

Licenses under this subchapter shall be issued for a period not exceeding fifty years. Each such license shall be conditioned upon acceptance by the licensee of all of the terms and conditions of this chapter and such further conditions, if any, as the Commission shall prescribe in conformity with this chapter, which said terms and conditions and the acceptance thereof shall be expressed in said license. Licenses may be revoked only for the reasons and in the manner prescribed under the provisions of this chapter, and may be altered or surrendered only upon *mutual agreement* between the licensee and the Commission after thirty days' public notice . . . .

FPA § 6, 16 U.S.C. § 799 (1994) (emphasis added).

39. *Pacific Gas & Elec. Co. v. FERC*, 720 F.2d 78, 83 (D.C. Cir. 1983); *Gas & Elec. Dep't of Holyoke Mass.*, 23 F.E.R.C. ¶ 61,172, at 61,172 (1983) (stating that: "[s]ection 6 provides licensees with the assurance that the authority conferred by a license for specific projects works will not be unduly

licensee when entering into the license agreement, and to induce reliance by the licensee on the contractual provisions.

Section 28 of the FPA further provides that congressional alteration of the FPA will not affect licenses that were issued prior to the statutory change.<sup>40</sup> Because Congress itself has expressly limited its power to pass legislation that would affect existing licensees, it seems evident that the FERC may not do the same.

Two statements reflecting contemporaneous construction of the original Act confirm the intent of Congress to give licensees contractual certainty. When the FPC, then consisting of the Secretaries of War, Interior, and Agriculture, issued its first public explanation of its activities, it referred to the license as a contract.<sup>41</sup> The First Annual Report of the FPC stated:

In place of the uncertain tenure and unknown requirements of previous legislation an applicant for a power project under the Federal Water Power Act may secure a license for a term not exceeding 50 years. The license is a contract between the Government and the licensee, expressly contains all the conditions which the licensee must fulfill, and, except for breach of conditions, can not be altered during its term either by the Executive or by Congress without the consent of the licensee.<sup>42</sup>

This view of the license as a contract was confirmed by the courts one year later in *Alabama Power Co. v. Gulf Power Co.*,<sup>43</sup> the first case to sustain the constitutionality of the FWPA. In *Alabama Power*, the court discussed the condemnation of lands of riparian owners under FWPA section 21. The court noted that the language of section 6 requires each licensee to accept conditions imposed by the license and concluded that "the matter of [the] license . . . becomes in its nature *the contract* between the licensee and the government . . ."<sup>44</sup>

In the foundation case of *Trustees of Dartmouth College v. Woodward*,<sup>45</sup> the Supreme Court characterized a public contract as a contract between a government entity and a private party.<sup>46</sup> The reason legislatures choose to adopt contractual terms in a grant or license is largely to induce

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impaired during the term of the license.") (citing *North Kern Water Storage Dist.*, 16 F.E.R.C. ¶ 61,082 (1981)).

40. Section 28 reads: "[T]he right to alter, amend, or repeal this Act is hereby expressly reserved, but no such alteration, amendment, or repeal shall affect any license theretofore issued under the provisions of this Act, or the rights of any licensee thereunder." FPA § 28, 16 U.S.C. § 822 (1994).

41. FIRST ANN. REP. OF THE F.P.C. at 50 (1921) [hereinafter FIRST ANN. REP.].

42. *Id.* (emphasis added). Prior to the passage of the FWPA, the administration of water powers under federal jurisdiction had been divided between three executive departments: Agriculture, Interior, and War. With the passage of the FWPA, jurisdiction was concentrated in the FPC. The responsibility for the work of the Commission originally rested with the Secretaries of Agriculture, Interior, and War. The First Annual Report was authored by the Secretaries of these Departments. *Id.* at 10-11.

43. *Alabama Power Co. v. Gulf Power Co.*, 283 F. 606 (M.D. Ala. 1922).

44. *Id.* at 615 (emphasis added).

45. *Trustees of Dartmouth College v. Woodward*, 17 U.S. 518, 518-19 (1819) (holding that since a charter granted to college trustees is covered by the contract clause, a legislative act altering the charter is an unconstitutional impairment of contract).

46. *Id.*

reliance by private investors.<sup>47</sup> Thus, Professor Laurence Tribe has noted that in the context of public contracts, “government may find it convenient, sometimes indeed imperative, to signal its trustworthiness and thus to induce the sort of reliance that it could instead have spurned . . . . [N]otions of fairness . . . point to a simple constitutional principle: *government must keep its word.*”<sup>48</sup>

The 1935 amendments to Part I of the FPA confirmed that the license is a contract. Congress added to section 6 a specific requirement that the licenses be deposited with the General Accounting Office (GAO).<sup>49</sup> This section requires that all *contracts* involving the payment of money by or to the government must be deposited at the GAO. This amendment was in response to an opinion of then-Attorney General Homer Cummings, who had ruled that Part I licenses were “administrative in character and are not to be construed as contracts connected with the settlement of public accounts within the meaning of section 20 of [t]itle 41 of the United States Code.”<sup>50</sup> Congress expressly overruled the Attorney General’s determination that a license was not a contract when it passed the amendment in 1935.

As late as 1968, the Commission reaffirmed the purpose of the FPA and its intent to create contractual and property expectations in the license. During the Hearings on H.R. 12698, which amended the FPA, participants discussed the possibility of a licensee’s right to seek an amendment of a license during the license term. Mr. Richard A. Solomon, General Counsel of the FPC at that time, stated that the licensee has the right to seek an amendment, but that a license is a contract, the terms of which are to be honored.<sup>51</sup>

*B. The FERC’s Failure to Renew a License or Pay Compensation upon License Expiration Constitutes Failure to Perform a Contractual Duty*

When licensees now approaching relicensing originally accepted their licenses, they did so with the understanding that the licenses would be renewed on reasonable terms or they would be paid compensation. This was the universally accepted interpretation of sections 14 and 15 of the

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47. Congress has, in other areas, indicated an intent to provide security to a grantee when conferring a privilege similar to a license. In *Civil Aeronautics Bd. v. Delta Air Lines Inc.*, 367 U.S. 316 (1961), the Supreme Court addressed the issue of how secure a certificate of public convenience and necessity should be. The Court concluded that: “Congress was vitally concerned with what has been called ‘security of route’—*i.e.*, providing assurance to the carrier that its investment in operations would be protected insofar as reasonably possible.” *Id.* at 324 (emphasis omitted).

48. LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 619 (2d ed. 1988) (emphasis in original). Professor Tribe was addressing what he calls the “Model of Settled Expectations.” *Id.* at 587-628.

49. Pub. L. No. 35-333, 49 Stat. 803, 841 (1935) (codified as amended at 16 U.S.C. § 799 (1994)).

50. 37 Op. Att’y Gen. 446 (1934).

51. *Hearings on H.R. 12,698 and 12,699 Before the Subcomm. on Communications and Power of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 70-71 (1968) (statement of Mr. Solomon, General Counsel of the Federal Power Commission).

FPA until the FERC's Policy Statement on Project Decommissioning. Sections 14 and 15, along with all of the other terms and conditions of the FPA, are expressly incorporated into every hydroelectric license and thus became contract terms binding both the licensee and the Commission. The promise that licensees would recoup their investments if forced to relinquish their property at license expiration was an important inducement for them to make the substantial capital investments necessary to develop the nation's hydropower resources.

The failure to perform a contractual duty when it is due is a breach of the contract.<sup>52</sup> Once it is established that an FPA license is a contract, the FERC's failure either to renew the license on reasonable terms or pay compensation would constitute a failure to perform its contractual duty under the terms of the license. Such a failure would therefore be a breach of contract—quite apart from whether the FERC's current view that it has statutory power to deny licenses or issue licenses on unreasonable (i.e. uneconomic) terms can be sustained. While future licensees may have difficulty claiming a reasonable expectation of being paid for losing the use of their property at license expiration, licensees who received their licenses prior to the FERC's 1994 Policy Statement would seem to have a powerful contract argument against uncompensated project decommissioning.

The fact that it is the Government which abrogates contractual rights should not prevent a licensee from obtaining relief for the breach. Government action which abrogates contractual rights is not necessarily immunized from liability.<sup>53</sup> The "just compensation" clause of the Fifth Amendment also prohibits the federal government from repudiating its contracts.<sup>54</sup>

The Government is sometimes excused from liability for breach of contract under the "sovereign acts" doctrine. Under this doctrine, the Government is immune from liability for breach of contract when it acts in its sovereign capacity, even if such actions infringe on existing contractual rights.<sup>55</sup> Furthermore, the Government cannot make a binding contract

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52. RESTATEMENT (SECOND) OF CONTRACTS § 235(2) (1981).

53. See, e.g., *Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995), cert. granted, 64 U.S.L.W. 2133 (U.S. Jan. 19, 1996) (No. 95-865) (holding that enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and enforcement of resulting regulations constituted a breach of contract by the federal government with respect to certain Supervisory Action Agreements made with banking institutions); *Everett Plywood Corp. v. United States*, 651 F.2d 723, 731-32 (Ct. Cl. 1981) (finding the Department of Interior liable for breach of contract for unilaterally terminating a timber contract); *Sun Oil Co. v. United States*, 572 F.2d 786, 814 (Ct. Cl. 1978) (holding that the Secretary of Interior cannot breach vested contractual rights under the "guise of protecting the . . . environment").

54. *Lynch v. United States*, 292 U.S. 571, 579 (1934).

55. *Horowitz v. United States*, 267 U.S. 458, 461 (1952). This doctrine should not be confused with the "unmistakability" principle, which holds that "contractual arrangements, including those to which a sovereign itself is a party, 'remain subject to subsequent legislation' by the sovereign." *Bowen v. Public Agencies Opposed to Social Sec. Entrapment*, 477 U.S. 41, 52 (1986) (quoting *Merrion v. Jicarilla Apache Tribe*, 450 U.S. 130 (1982)). The Unmistakability doctrine does not apply to cases where a federal agency, such as the FERC, misinterprets a current statute. Further, FPA section 28 prevents Congress from unilaterally altering existing licenses.

that it will not exercise its sovereign power.<sup>56</sup> However, the Government can agree that if it exercises its sovereign power, "it will pay the other contracting party the amount by which its costs are increased by the Government's sovereign act."<sup>57</sup>

The U.S. Court of Claims relied on the "sovereign acts" doctrine in *Amino Brothers Co. v. United States*<sup>58</sup> in holding that a release of flood waters by the Corps of Engineers which washed out plaintiff's low-water crossing and prevented plaintiff from completing a flood control project under contract with the Corps did not entitle the plaintiff to equitable relief under its contract. The court stated that the Government was acting in its sovereign capacity for protection of the public and was therefore not liable.<sup>59</sup>

In contrast, the U.S. Court of Claims held in *Sunswick Corp. of Delaware v. United States*<sup>60</sup> that the federal government was liable for breach of contract when it ordered the plaintiff to pay a higher wage than that called for in a construction contract made between the Corps of Engineers and the plaintiff.<sup>61</sup> The Government was found liable in this case because the contract itself bound the Government to offer a remedy to the plaintiff under circumstances that might otherwise be nonactionable as an act of the sovereign.<sup>62</sup>

Sections 14 and 28 of the FPA place a restriction on the Government's ability to exercise its sovereign power to change the treatment of current licensees. These sections provide a remedy for licensees adversely affected by changes in policy. Section 14 states that the federal government may take over a project; however, this activity must occur through condemnation and payment of compensation.<sup>63</sup> Section 28 further provides that if Congress alters the FPA after the issuance of licenses, such alteration will not affect the licenses already issued.<sup>64</sup> The inclusion of these provisions in the FPA makes clear that neither Congress nor the Commission may alter the regulatory treatment of current licensees without paying damages for any adverse effects brought about by such changes. Therefore, sovereign immunity does not provide a defense to the financial harm that may result from an order to decommission a facility.<sup>65</sup>

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56. *Amino Bros. v. United States*, 372 F.2d 485, 491 (Ct. Cl. 1967) (citing *Meyne Co. v. United States*, 76 F. Supp. 811 (Ct. Cl. 1948)); *Sunswick Corp. of Del. v. United States*, 75 F. Supp. 221 (Ct. Cl.), *cert. denied*, 334 U.S. 827 (1948).

57. *Amino Bros.*, 372 F.2d at 491.

58. *Id.* at 485.

59. *Id.* at 491.

60. *Sunswick Corp. of Del.*, 75 F. Supp. at 221.

61. *Id.* at 231.

62. *See id.* at 228.

63. FPA § 14, 16 U.S.C. § 807 (1994).

64. FPA § 28, 16 U.S.C. § 822 (1994).

65. "[W]hen agents of the Government, without justification in statute, executive order, administrative discretion or otherwise, engage in conduct which is a violation of an express or implied provision of a Government contract, the mantle of sovereignty does not give the Government immunity from suit." *Ottinger v. United States*, 88 F. Supp. 881, 883 (Ct. Cl. 1950).

#### IV. SITUATIONS WHERE THE FERC'S DECOMMISSIONING POLICY STATEMENT WOULD RESULT IN A REGULATORY TAKING

Recent trends expanding the rights of property owners affected by government regulation raise the question whether implementation of the decommissioning Policy Statement will result in a "taking" of private property without just compensation<sup>66</sup> in violation of the Fifth Amendment to the United States Constitution.<sup>67</sup> The FERC casually dismissed this possibility in the Policy Statement, noting that several commentators had raised the issue but that resulting comments were made "without legal discussion or citation."<sup>68</sup> The authors believe that the FERC considered the takings argument much too lightly.<sup>69</sup>

It is firmly established that a federal regulatory action that "goes too far" will amount to a taking of private property without compensation.<sup>70</sup> Under the traditional regulatory takings analysis, the determination of whether a government action can be considered a taking generally is made by balancing the government's interest in the government action against the property owner's economic interest in the property at issue, and analyzing whether the action has infringed on the owner's property rights to such an extent that compensation is required. Courts will first determine whether a property interest existed at the time of the government activity. Once a property interest is established, courts will look at the following factors in determining whether a government action constitutes a taking requiring just compensation: (1) the character of the government action; (2) the economic impact of the government action on the party who suffers the taking; and (3) the extent to which the action interferes with reasonable investment-backed expectations.<sup>71</sup>

##### A. Property Interest

A crucial threshold requirement in the regulatory takings analysis is whether a compensable property interest exists at the time of the taking. Generally, whether a property interest exists is a question of state law. A hydropower owner's property interests may include land, the project

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66. One commentator has suggested that FPA section 14's limitation on compensation for federal takeover to "net investment" is a "taking" because it is substantially less than fair market value. Catherine R. Connors, *Appalachian Electric Revisited: The Recapture Provision of the Federal Power Act after Nollan and Kaiser Aetna*, 40 *DRAKE L. REV.* 533 (1991).

67. The takings clause of the Fifth Amendment states "nor shall private property be taken for public use, without just compensation." U.S. CONST. amend. V. This provision applies directly to the federal government, and indirectly to the states through the Fourteenth Amendment. The Fifth Amendment encompasses property owned by state and local governments. *United States v. 50 Acres of Land*, 469 U.S. 24, 31 (1984).

68. Policy Statement, *supra* note 5, at 348.

69. Arguably, the burden was on the FERC to justify its rejection of the takings argument. See Exec. Order No. 12,630, 53 Fed. Reg. 8859 (1988) (stating that government agencies should review their actions to prevent unnecessary takings).

70. *Pennsylvania Coal Co.*, 260 U.S. at 415.

71. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).

works, water rights, or all of these.<sup>72</sup> There is also a property interest in the federal license itself.

The Commission requires a licensee to acquire property rights in the project as a condition to obtaining a license.<sup>73</sup> In addition, FPA section 13 requires the licensee to begin construction of the project as a condition of license approval.<sup>74</sup> Section 21 grants the licensee the power of eminent domain if it is unable to obtain a site for the project.<sup>75</sup> All of these provisions mandate, as a condition of the license, that the licensee will acquire property rights in order to perfect the license. As discussed above, the FPA's inducement for the licensee to make these investments is its promise of secure expectations in the licensed property interests.

### 1. Land and Project Works

Hydropower projects may be located on property owned by the project operator in fee, on property leased by the operator, on land obtained by easement, on federal land, or on a combination of any of these types of property. Except for federal lands, real property interests are clearly compensable property interests for takings purposes. Improvements on the

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72. The FPA recognizes various property rights in a hydroelectric project. The FPA defines the "project" as including:

[The] complete unit of improvement or development, consisting of a power house, all water conduits, all dams and appurtenant works and structures (including navigation structures) . . . all storage, diverting or forebay reservoirs directly connected therewith, the primary line or lines transmitting power therefrom to the point of junction with the distribution system or with the interconnected primary transmission system, all miscellaneous structures used and useful in connection with said unit, or any part thereof, and all water-rights, rights-of-way, ditches, dams, reservoirs, lands, or interest in lands the use and occupancy of which are necessary or appropriate in the maintenance and operation of such unit.

16 U.S.C. § 796(11) (1994). "Project works" are the physical structures of the project. *Id.* § 796(12).

73. See, e.g., Form L-1, Art. 5, Standardized Conditions for Inclusion in Preliminary Permits and Licenses Issued Under Part I of the Federal Power Act, 54 F.P.C. 1792, 1801 (1975) [hereinafter Standard Conditions].

74. Section 13 states:

The licensee shall commence the construction of the project works within the time fixed in the license, which shall not be more than two years from the date thereof, shall thereafter in good faith and with due diligence prosecute such construction, and shall within the time fixed in the license complete and put into operation such part of the ultimate development as the Commission shall deem necessary . . . .

FPA § 13, 16 U.S.C. § 806 (1994).

75. Section 21 states:

When a licensee cannot acquire by contract or pledges an unimproved dam site or the right to use or damage the lands or property of others necessary to the construction, maintenance, or operation of any dam, reservoir, diversion structure, or the works appurtenant or accessory thereto, in conjunction with any improvement which in the judgment of the [C]ommission is desirable and justified in the public interest for the purpose of improving or developing a waterway or waterways for the use or benefit of interstate or foreign commerce, it may acquire the same by the exercise of the right of eminent domain . . . .

FPA § 21, 16 U.S.C. § 814 (1994).

land are also compensable property interests under the Fifth Amendment.<sup>76</sup>

## 2. Water Rights

The FPA and the FERC's standard license conditions include water rights as project property.<sup>77</sup> Whether and to what extent there can be a regulatory taking of water rights is currently a hotly debated topic, however.<sup>78</sup> A water right, by its nature, is "usufructuary"—solely a right to the use of the water.<sup>79</sup> As stated by the California Supreme Court in *Lux v. Haggin*,<sup>80</sup> the usufructuary right is the crucial element within the water right and thus a water right "consists not so much in fluid itself as in its uses."<sup>81</sup>

Section 27 of the FPA<sup>82</sup> reserves to the states the right to determine proprietary interests in water.<sup>83</sup> It is therefore necessary to look to state law when assessing a licensee's compensable property interests in project water rights.

There are two types of water rights recognized in the United States: riparian and appropriative. While some states recognize both types,<sup>84</sup> there is generally a geographic schism with the eastern United States employing the riparian doctrine and states west of the Mississippi recognizing prior appropriative rights.

### a. Riparian Water Rights—Eastern United States

The eastern states primarily depend upon a riparian system of water rights.<sup>85</sup> Riparian water rights holders are entitled to water by virtue of their status as owners of riparian lands. Such owners have the right to as much of the water flowing through their lands as they may apply to reasonable uses.<sup>86</sup> In most riparian states, water cannot be diverted outside of the

76. *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893) (awarding damages for the federal taking of a navigational lock and dam).

77. 16 U.S.C. § 796(11) (1994). See also Standard Conditions, *supra* note 77, at Art. 5.

78. For further discussion of the controversy surrounding regulatory takings of water rights, see Joseph L. Sax, *The Constitution, Property Rights and the Future of Water Law*, 61 U. COLO. L. REV. 257, 260 (1990) (arguing that regulations may constitutionally "constrain pre-existing uses or rights that were legal when initiated . . ."). See also Gregory J. Hobbs, Jr. & Bennett W. Raley, *Water Rights Protection in Water Quality Law*, 60 U. COLO. L. REV. 841, 893-98 (1989) (arguing that federal regulations reallocating water rights constitute regulatory takings).

79. *Sauve v. Abbott*, 19 F.2d 619, 620 (E.D. Idaho 1927) (stating: "One does not own water in Idaho. He can acquire only the right to a use for beneficial purposes . . .").

80. 10 P. 674 (Cal. 1886).

81. *Id.* at 753.

82. 16 U.S.C. § 821 (1994).

83. *California v. FERC*, 495 U.S. 490, 498 (1990).

84. For example, California recognizes both riparian and appropriative rights. See Tara L. Mueller, *Federal Regulation of Water Resources: Does the Limited Nature of Property Interests in Water Preclude a Taking?*, 3 ENVTL. L. NEWS 2, 12 (1994).

85. WILLIAM GOLDFARB, *WATER LAW* 21 (2d ed. 1988). All states east of the Mississippi River, except Mississippi, as well as Arkansas, Iowa, and Missouri, employ a riparian rights system. *Id.*

86. *Id.* at 24.

stream's watershed of origin and must be applied only to the riparian tract itself.<sup>87</sup> Riparian water rights are not lost by non-use.<sup>88</sup> Finally, riparian water rights are correlative.<sup>89</sup> If the amount of water in the stream is insufficient to satisfy all of the demands on it, riparian owners may be required to reduce their consumption in proportion to their use, until there is sufficient water available to satisfy all riparian owners' reasonable needs.<sup>90</sup>

b. Prior Appropriation—Western United States

Under the appropriative water rights system, rights to water are not determined by one's status as a landowner. Rather, one obtains a water right by diligently constructing diversion and distribution works and by applying the water to a reasonable and beneficial use. Water obtained by appropriation may be diverted and applied to lands located outside of the stream's watershed of origin.<sup>91</sup> Unlike riparian rights, appropriative rights are forfeited by non-use.<sup>92</sup> Finally, also unlike the riparian system, disputes between appropriators are resolved by the concept of "first in time, first in right."<sup>93</sup> Thus, in times of shortage, the most junior appropriator is required to reduce or even completely abate his or her use of water first, then the next most junior appropriator, and so on, until there is sufficient water available to meet the reasonable needs of each senior appropriator.<sup>94</sup> An appropriative right must be put to a "beneficial use."<sup>95</sup> Hydropower is typically defined as a beneficial use by state statute.<sup>96</sup>

The appropriative system may also be subject to the "public trust doctrine" which holds that water is public property belonging to all citizens of a state.<sup>97</sup> As such, it is subject to regulations protecting public uses.<sup>98</sup> For example, in *National Audubon Society v. Superior Court of Alpine City*,<sup>99</sup>

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87. *Id.* at 22.

88. *Id.* at 34.

89. *Id.* at 23.

90. GOLDFARB, *supra* note 85, at 23.

91. GOLDFARB, *supra* note 85, at 33-34. *See also* A. DAN TARLOCK, LAW OF WATER RIGHTS AND RESOURCES 5-31 (1988).

92. GOLDFARB, *supra* note 85, at 34.

93. *State ex rel. Cary v. Cochran*, 292 N.W. 239, 242 (Neb. 1940) (recognizing water rights of irrigation district and power generation as controlling over other claimants since "the principle priority of time bestows priority of right").

94. *Id.* at 245 (noting that: "In times of water shortage, the latter [sic] appropriations are the first to be deprived of water").

95. GOLDFARB, *supra* note 85, at 35.

96. *See, e.g.*, OR. REV. STAT. § 536.300(1) (1993); WASH. REV. CODE ANN. § 43.27A.020 (West 1994); COLO. REV. STAT. ANN. § 31-35-401(7) (West 1995).

97. For a thorough discussion of the public trust doctrine, *see* Joseph L. Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471 (1970).

98. GOLDFARB, *supra* note 85, at 114. *See also* Sax, *supra* note 78, at 260 (arguing that retroactivity is not the test of compensability when regulations constrain pre-existing water uses or rights).

99. 658 P.2d 709 (Cal. 1983), *cert. denied*, 464 U.S. 977 (1983).

the California Supreme Court held that the reallocation of water for scenic preservation may not be a taking under the Fifth Amendment because the water rights holder's property interest was subject to the public trust from the beginning.<sup>100</sup> This decision is an example of California's use of the doctrine for the benefit of the "public interest" over those individuals asserting water rights.<sup>101</sup> In contrast, the Colorado Supreme Court has rejected the public trust doctrine.<sup>102</sup> The extent to which the public trust doctrine limits a licensee's compensable property interests in project water rights will undoubtedly depend upon the state in which the project is located.

c. The Navigational Servitude

Congress has the dominant authority under the Commerce Clause<sup>103</sup> to regulate and control matters relating to navigable waters.<sup>104</sup> However, in *FPC v. Niagara Mohawk Power Corp. (Niagara Mohawk)*,<sup>105</sup> the Supreme Court held that licenses issued under the FPA are not subject to the navigational servitude.<sup>106</sup> The Court reasoned that the FPA is a plan for "reasonable regulation of the use of navigable waters," not an "assertion of the paramount right of the Government to use the flow" of navigable streams.<sup>107</sup> Among other things, the Court cited FPA section 27, which expressly preserves state-granted water rights from federal preemption.<sup>108</sup>

Furthermore, even if FPA licenses were subject to the navigational servitude, not all projects would be affected by it. Section 23(b) of the FPA grants the FERC jurisdiction over projects on both navigable and non-navigable waters, as well as over projects located on federal land and projects using surplus water from a government dam.<sup>109</sup> Even with respect to projects on navigable waters, the Supreme Court held in *Kaiser Aetna v. United States*<sup>110</sup> that the navigational servitude does not "create a blanket exception" to the requirement that compensation be paid for the proprie-

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100. *Id.* at 719-23.

101. California courts have recognized a progression of changes in water law that place a greater emphasis on the "public" than do most states. For a discussion, see Sax, *supra* note 78.

102. *People v. Emmett*, 597 P.2d 1025 (Colo. 1979) (holding that the framers of the state constitution intended that the waters of natural streams be dedicated to appropriation and use).

103. U.S. CONST. art. I, § 8, cl. 3.

104. GOLDFARB, *supra* note 85, at 73-74.

105. 347 U.S. 239 (1954).

106. *Id.* at 248. In *Wisconsin Power & Light Co.*, 33 F.P.C. 275 (1965), the Commission relied upon *United States v. Chandler-Dunbar Water Power Co.*, 229 U.S. 53 (1913), for the proposition that, in the case of a "minor" project for which sections 14 and 15 have been waived, the Commission may "clear the stream" under the navigational servitude. *Niagara Mohawk*, 347 U.S. at 276. However, *Chandler-Dunbar* did not involve a license issued under the FPA. Furthermore, the Commission failed to discuss *Niagara Mohawk* in either *Wisconsin Power & Light Co.* or the Commission's Policy Statement.

107. *Niagara Mohawk*, 347 U.S. at 251.

108. 16 U.S.C. § 821 (1994).

109. *Id.* § 816.

110. 444 U.S. 164 (1979).

tary interest in the use of water.<sup>111</sup> In that case, the owners of a marina made improvements which resulted in the marina being classified as navigable waters of the United States. The Court held that, while the federal government could force the owners to make the marina available to the public, the owners would have to be compensated for such action.<sup>112</sup>

Finally, hydropower projects are much more likely to experience takings of property interests for the environmental purposes listed in the FERC Policy Statement<sup>113</sup> than for navigational purposes.

### 3. License

Licenses are generally held not to be compensable property interests.<sup>114</sup> However, the Supreme Court has held that “[v]alid contracts are property, whether the obligor be a private individual, a municipality, a state, or the United States,” and that “[r]ights against the United States arising out of a contract with it are protected by the Fifth Amendment.”<sup>115</sup> As discussed above,<sup>116</sup> statutory construction, interpretation by the courts, and legislative history all demonstrate that a license under Part I of the FPA is a contract. As such, it is a property interest protected under the Fifth Amendment.

#### B. Establishing a Takings Claim

Once a property interest has been defined for the purpose of bringing a takings claim, the courts proceed to the takings analysis. Courts have been struggling over the last 74 years to develop standards for determining when a “regulatory taking” occurs and what the remedy should be when one does occur. Most courts shun legal generalizations in regulatory takings cases and instead emphasize *ad hoc* factual inquiry on a case-by-case basis. In some instances, however, the Supreme Court has established “categorical rules” pertaining to regulatory takings.

##### 1. The FERC’s Authority to Order Decommissioning as a “Taking Per Se”

The Supreme Court has formulated two categorical rules that establish *per se* the existence of a regulatory taking. The first categorical rule involves situations where the governmental activity at issue results in a physical invasion of the property. The Supreme Court has ruled that a physical occupation of the property, no matter how small, effects a taking.<sup>117</sup>

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111. *Id.* at 172.

112. *Id.* at 179-80.

113. Policy Statement, *supra* note 5, at 342.

114. ALFRED D. JAHR, *EMINENT DOMAIN: VALUATION AND PROCEDURE* 299 (1957).

115. *Lynch v. United States*, 292 U.S. 571, 579 (1934).

116. *See supra* part III.A.

117. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 436 (1982).

The second categorical rule was established in *Lucas v. South Carolina Coastal Council*.<sup>118</sup> The Court held that when the government action denies the property owner “all economically beneficial or productive use” of the property interest, the activity is a taking *per se*, and just compensation is required.<sup>119</sup> The Court justified this rule by stating:

[R]egulations that leave the owner of land without economically beneficial or productive options for its use—typically, as here, by requiring land to be left substantially in its natural state—carry with them a heightened risk that private property is being pressed into some form of public service under the guise of mitigating serious public harm.<sup>120</sup>

The one exception to this rule is that, where a “total taking” occurs, the Government can avoid compensation where the proscribed use interests were not part of the owner’s title to begin with:

[A] limitation so severe [as to effect a “total taking”] cannot be newly legislated or decreed (without compensation), but must inhere in the title itself, in the restrictions that background principles of the State’s law of property and nuisance already place upon land ownership.<sup>121</sup>

... [A]pplication of state nuisance law ordinarily entails analysis of . . . the degree of harm to public lands and resources, or adjacent private property, posed by the claimant’s proposed activities, the social value of the claimant’s activities and their suitability to the locality in question, and the relative ease with which the alleged harm can be avoided through measures taken by the claimant and the government (or adjacent private landowners) alike  
 . . . .<sup>122</sup>

To help clarify its reference to background principles of nuisance and property law, the Court offered in *Lucas* the example of a landowner denied a permit to conduct a landfilling operation that would result in downstream flooding of land belonging to other landowners. According to the Court, the landowner would not be entitled to compensation for the governmental restriction imposed upon this use of land.<sup>123</sup> Similarly, the corporate owner of a nuclear generating plant is not entitled to compensation when it is required to remove all improvements from its land upon discovery that the plant is located on an earthquake fault.<sup>124</sup>

Generally, “background principles” of state nuisance law will not create an exception to requiring compensation for the decommissioning of hydroelectric plants. Generation of hydroelectric power is usually considered a “beneficial use” under state law, as opposed to being considered a nuisance.<sup>125</sup> It is non-polluting and not generally hazardous. Unless the

118. 112 S. Ct. 2886 (1992).

119. *Id.* at 2893, 2899 (emphasis added) (holding that where there has been a complete diminution in value, there has been a taking and there is no need for case-specific inquiry into the public interest advanced in support of the restraint).

120. *Id.* at 2894-95 (citations omitted).

121. *Id.* at 2900.

122. *Id.* at 2901 (citations omitted).

123. *Id.* at 2900-01.

124. *Lucas*, 112 S. Ct. at 2900.

125. *See supra* note 96.

dam presents a public health or safety hazard or damages the property of a third party, the nuisance exception should not generally apply.

In its Policy Statement, the FERC claims authority to: (1) deny a license at renewal and order decommissioning of the project; and (2) issue a license with environmental conditions which render a project uneconomical. In the first instance, the FERC is denying the licensee "all economically beneficial or productive use" of the hydroelectric plant by either ordering that a project's power be shut off, or by requiring that the dam and project works be removed and that the licensee restore the project to pre-project environmental conditions. The licensee is left with no economical or productive use of the property interests contained in the project, thus establishing a taking *per se*.

In the second instance, the FERC states that the environmental conditions imposed upon the new license may force the licensee out of business, because the "costs of doing business have become too high."<sup>126</sup> In this instance, the FERC is again leaving no economically beneficial or productive use of the property interest at issue, establishing a taking *per se*. In fact, the FERC has admitted in recent orders that in order to continue operations, the licensee would have to operate at a loss—although by doing so, the licensee would avoid the even greater costs of decommissioning.<sup>127</sup>

While theoretically the land upon which the project is located could be converted to other uses, such conversion would be unlikely to occur. Most hydroelectric projects are located in remote areas or otherwise on property with limited real estate value. Were the dam allowed to remain in place, the most likely use would be recreation, which typically would yield little or no income. The generating facilities themselves may have only scrap value.

As for water rights, most prior appropriation states impose strict conditions on or disallow the transfer of nonconsumptive uses to consumptive ones.<sup>128</sup> Therefore, a licensee may have a very limited ability to use or market its water rights. Under the "use it or lose it" doctrine, this could result in abandonment and loss of the water rights. In riparian states, the right to use the water attaches to the land, and therefore is not easily transferable.

In sum, it is highly unlikely that the licensee would be left with any economical or productive property use. In fact, the project may end up with a negative value, because in some cases the FERC may force the licensee to spend money to restore the site to its pre-project condition, or the project may continue to operate, but at a loss.

There is a third scenario, not discussed in the Policy Statement. That is where the FERC imposes conditions so that the project might still operate, but perhaps under marginal economic conditions. In these cases, the question becomes: how far can the FERC go before the situation becomes a

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126. Policy Statement, *supra* note 5, at 343.

127. See *supra* notes 33-34.

128. GOLDFARB, *supra* note 85, at 34-35.

taking? In situations where the conditions restrict, but do not entirely eliminate, the use of the property, what factors will the courts examine to determine whether a taking has occurred? In cases that involve a denial of less than all economically viable use, courts have not established a categorical rule to determine whether a regulation "goes too far." Instead, a court engages in *ad hoc* factual inquiries.

## 2. Ad Hoc Factual Inquiry

When engaging in *ad hoc* factual inquiries, the Supreme Court has identified three factors of particular importance to apply in determining whether government action constitutes a taking requiring just compensation: (1) the character of the government action; (2) the economic impact of the government action on the party who claims the taking; and (3) the extent to which the action interferes with reasonable investment-backed expectations.<sup>129</sup>

### a. The Character of the Government Action

Reviewing courts will consider the purpose and importance of the public interest reflected in the regulatory imposition. Courts will balance the liberty interest of the private property owner against the Government's need to protect the public interest through imposition of the restraint.<sup>130</sup> Generally speaking, when the Government prohibits activity that had formerly been allowed, a taking may be found if the Government is attempting to achieve a general public goal at the expense of an individual landowner.<sup>131</sup> Federal actions constituting a taking may include, for example, the denial of a permit to develop wetlands required under section 404 of the Clean Water Act.<sup>132</sup>

For hydroelectric projects, the government action at issue is the imposition of conditions that would make the project marginally economic. The public interest to be advanced by that action is primarily the protection to the environment provided by those conditions. Courts would then weigh the importance of that interest against the liberty interest of the licensee to operate economically. It is possible that a court might determine that the FERC is attempting to achieve a public goal at the expense of the landowner. It should be noted, however, that the public also has an interest in the generation of clean, renewable energy, in public recreation, and in other benefits provided by hydroelectric projects. The FERC has recognized these public interests when it has issued new licenses hoping that the

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129. Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

130. Loveladies Harbor, Inc. v. United States, 28 F.3d 1171, 1176 (Fed. Cir. 1994).

131. Florida Rock Indus., Inc. v. United States, 791 F.2d 893, 905 (Fed. Cir. 1986), *remanded*, 21 Cl. Ct. 161 (1990), *vacated and remanded on other grounds*, 18 F.3d 1560 (Fed. Cir. 1994), *cert. denied*, 115 S. Ct. 898 (1995).

132. See, e.g., *Loveladies Harbor, Inc.*, 28 F.3d at 1171; *Bowles v. United States*, 31 Cl. Ct. 37 (1994).

licensee will be willing to operate at a loss.<sup>133</sup> Because there are competing public interests, this may help tip the balance in favor of the licensee.

In addition to the considerations referenced above, the Supreme Court has held that there must be an "essential nexus" between the state's legitimate interest in preventing injury to the public from a permitted improvement to property and the conditions imposed on that improvement to protect the state's interest.<sup>134</sup> In the recent case of *Dolan v. City of Tigard*,<sup>135</sup> the Supreme Court established that in order for a governmental entity to impose "exactions" (land use requirements imposed as a *quid pro quo* for obtaining a requested permit) on a landowner's property in exchange for a building permit, there must be a "rough proportionality" between those exactions and the impact of the proposed development for which the permit is being sought.<sup>136</sup> The burden of showing "rough proportionality" rests on the government body imposing the restriction.<sup>137</sup>

In the case of decommissioning, if the conditions the FERC seeks to impose are viewed as analogous to land use requirements for obtaining a permit, the public interests jeopardized by renewal are difficult to discern. The "impact of the proposed development" is continued operation of the project, which is essentially a continuation of the status quo. The status quo provides both benefits and costs to the public. Expensive fish ladders and other types of environmental conditions designed to approximate the pre-facility ecosystem are not proportionate exactions for the impacts of continued use. The FERC's imposition of onerous environmental conditions under the guise of "environmental enhancement" can be seen, in essence, as an attempt to correct for *original* project impacts, not protection against the actual activity being licensed, *i.e.*, continued operation. Extensive environmental mitigation measures which cripple the economics of an ongoing project may be difficult to justify under the rough proportionality test.<sup>138</sup>

#### b. The Economic Impact of the Governmental Activity

The second of the three factors typically weighed by the courts in determining whether a regulatory taking has occurred is "the economic impact" of the government action on the claimant.

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133. See, e.g., *Upper Peninsula Power Co.*, 72 F.E.R.C. ¶ 62,188, at 64,404; *Duke Power Co.*, 72 F.E.R.C. ¶ 61,030, at 61,185.

134. *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987).

135. 114 S. Ct. 2309, *remanded*, 877 P.2d 1201 (Or. 1994).

136. *Dolan*, 114 S. Ct. at 2319-20.

137. *Id.* at 2319-20, 2322.

138. Interestingly, the FERC itself has invoked a "roughly proportionate" test for determining the appropriate level of mitigation for adverse project impacts. *Ohio Power Co.*, 71 F.E.R.C. ¶ 61,092, at 61,317 (1995).

When the government activity deprives the property owner of less than all use or economic value of the property, courts will compare the value of the property before the government action with the value after the government action to determine whether a sufficient diminution in value has occurred to establish a taking.<sup>139</sup> Generally, "fair market value" is the valuation term used, and is generally defined as the amount of money for which the property would be sold by a knowledgeable owner willing—but not obligated—to sell to a knowledgeable purchaser.<sup>140</sup> Courts have found sufficient to constitute a taking reductions in value of: 99%;<sup>141</sup> 95%;<sup>142</sup> 91.8%;<sup>143</sup> and 88%.<sup>144</sup> Courts will sometimes look to see if the owner is able to recoup his or her investment to determine whether a substantial loss has occurred.<sup>145</sup> "Mere diminution in value," standing alone, does not result in a compensable taking.<sup>146</sup> To date, no court has awarded compensation for a regulatory taking where the reduction in the value of property is less than 88%.

In cases where conditions imposed by the FERC on a new license make the project marginally economic, valuation will be an important issue. The "fair market standard" is difficult to apply because hydroelectric plants are rarely sold. An alternative method of determining the value of the power plant might be to compare the cost of producing power both before and after the conditions are imposed to the cost of obtaining alternative power. For example, assume that before the conditions are imposed, the cost of producing power is \$.01 per kWh, and after the conditions are imposed the cost increases to \$.05. The cost of alternative power is \$.06. The project will remain economic as long as the cost of producing power is less than the cost of purchasing alternative power. However, the FERC has essentially taken 80% of the value out of the project, *i.e.*, 80% of the difference between the cost of project power and the cost of alternative power. A counter argument may be offered that increasing the cost of producing power merely requires the licensee to spend money to protect the environment. If the money were for the purpose of protecting health and

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139. See, *e.g.*, *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 497 (1987); *Goldblatt v. Hempstead*, 369 U.S. 590, 594 (1962).

140. See *Bowles v. United States*, 31 Cl. Ct. 37, 46 (1994). There are, however, many methods of valuation. "Value" has been variously defined as fair market value, cash market value, fair cash market value, actual value, current cost of reproduction less depreciation, original cost of the property, and the price of comparable properties in the market. 4 JULIUS L. SACKMAN & PATRICK ROHAN, NICHOLS' THE LAW OF EMINENT DOMAIN § 12.01 (3d ed. 1976 & Supp. 1995).

141. *Loveladies Harbor, Inc. v. United States*, 21 Cl. Ct. 153, 160 (1990), *aff'd*, 28 F.3d 1171 (Fed. Cir. 1994).

142. *Florida Rock Indus., Inc.*, 21 Cl. Ct. at 175.

143. *Bowles*, 31 Cl. Ct. at 48.

144. *Formanek v. United States*, 26 Cl. Ct. 332, 340 (1992).

145. *Florida Rock Indus., Inc.*, 791 F.2d at 905.

146. *Penn Cent. Transp. Co.*, 438 U.S. at 131.

safety, a court would most likely uphold the license conditions.<sup>147</sup> As discussed above, however, this would rarely be the case for a hydroelectric project.

### c. Investment-Backed Expectations

The third factor courts consider in determining whether an unconstitutional taking has occurred is whether the action has adversely affected the property owner's reasonable investment-backed expectations.<sup>148</sup> In *Penn Central*, the regulation in question did not interfere with the current uses of the property and allowed a reasonable return on the original investment made in the property. The Court therefore held that the restrictions did not interfere with the plaintiff's investment-backed expectations.

Some might argue that hydroelectric licensees have received a reasonable return on their original investments, and that they are not entitled to more. On the contrary, sections 14 and 15 of the FPA establish that the licensee has the right to expect either a license renewal upon reasonable terms, or takeover of the project and payment of compensation. Under this statutory scheme, the licensee retains a property right throughout the term of the license and beyond, until the project is taken over and the licensee is paid for that interest. Moreover, when a licensee is subject to decommissioning costs, or forced to operate a project at a loss, it loses the benefit of the contract it made with Commission when it accepted the original license. Further, the FERC Policy Statement will require holders of water rights to reduce longstanding uses of water, thereby disrupting settled expectations regarding the amount of water to which these water users are entitled. The reasonable, investment-backed expectations factor would appear to weigh heavily in favor of hydroelectric licensees.

### C. Procedural Issues

Takings claims may be brought only after a governmental action has occurred that results in a taking. The United States Court of Federal Claims (Claims Court) has exclusive jurisdiction over takings claims against the Government for sums in excess of \$10,000. Claims for lesser amounts may be brought in either the Claims Court or in federal district court.

As a general principle, a property owner may not file a takings claim until all administrative remedies have been exhausted. Where the right to appeal an agency decision to an appellate board is provided by statute, that administrative remedy must normally be exhausted before one may seek

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147. See *Atlas Corp. v. United States*, 895 F.2d 745, 756 (Fed. Cir. 1990), *cert. denied*, 498 U.S. 811 (1990) (holding that "[r]equiring money to be spent is not a taking of property" where a uranium producer was required to spend large sums of money for reclamation of tailings and mill decommissioning upon termination of a license).

148. *Penn Cent. Transp. Co.*, 438 U.S. at 124-25.

relief in court. Section 313 of the FPA<sup>149</sup> provides that appeal of a licensing decision by the FERC is made in a federal circuit court. Therefore, a licensee must appeal a license decision in federal appellate court prior to bringing a takings claim for compensation in the U.S. Court of Claims. A number of procedural questions remain, however, such as whether the licensee can, or should, raise the takings issue in the appeal of the license decision. Those issues, while interesting and important, are beyond the scope of this article.

If the plaintiff is successful in a takings claim, or if the case is settled, the court may award "reasonable" attorney's fees to the plaintiff under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970.<sup>150</sup> The reasonableness of attorney's fees depends on various factors, including the novelty and difficulty of the questions involved, the time consumed, and the results obtained. Reimbursable costs also include other litigation costs, such as the costs of expert witnesses, printing, and graphic and transcription services.

## V. PRIVATE PROPERTY RIGHTS LEGISLATION

Due to the confusion surrounding the jurisprudence of regulatory takings,<sup>151</sup> and the lack of categorical rules, some are looking to Congress for a "legislative fix" to clarify takings law. Federal legislation specifically addressing the protection of private property rights is relatively new. The first free-standing property rights bill requiring compensation to the property owner for the "taking" of private property was introduced in 1990. Since then, the number of property rights bills and amendments offered in Congress has increased each year. For example, in 1993 and 1994, the first recorded votes on private property rights occurred on seven separate occasions in the House of Representatives.

Generally, the purpose of private property rights legislation has been either to provide a mechanism for ensuring that federal actions do not result in the taking of private property, or to provide a statutory mechanism for obtaining compensation from the federal government for reduc-

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149. 16 U.S.C. § 8251 (1994).

150. 42 U.S.C. §§ 4601-4655 (1994).

151. As noted by Chief Judge Loren Smith in a recent case in the Court of Federal Claims:

This case presents in sharp relief the difficulty that current takings law forces upon both the federal government and the private citizen. The government here had little guidance from the law as to whether its action was a taking in advance of a long and expensive course of litigation. The citizen likewise had little more precedential guidance than faith in the justice of his cause to sustain a long and costly suit in several courts. There must be a better way to balance legitimate public goals with fundamental individual rights. Courts, however, cannot produce comprehensive solutions. They can only interpret the rather precise language of the fifth amendment to our Constitution in very specific factual circumstances . . . . Judicial decisions are far less sensitive to societal problems than the law and policy made by the political branches of our great constitutional system. At best courts sketch the outlines of individual rights, they cannot hope to fill in the portrait of wise and just social and economic policy.

*Bowles*, 31 Cl. Ct. at 39.

tions in the value of privately-owned property caused by land use restrictions, or both. The reason for increased interest in property rights legislation is largely due to problems that citizens have been encountering with two federal environmental statutes that affect property rights directly: the Clean Water Act, particularly the section 404 program; and the Endangered Species Act.

A growing number of Members of Congress believe private property legislation is needed for three significant purposes: (1) to restrain, within acceptable limits, federal environmental programs that affect private property; (2) to provide property owners a method to obtain compensation for the loss of private property without being required to sue the federal government under the Fifth Amendment in the Claims Court in Washington, D.C.; and (3) in order to provide compensation for landowners at levels of loss less than the approximately 90% loss in property value that Supreme Court decisions indicate is required for compensation under the Fifth Amendment.

In the current Congress, private property rights legislation is under consideration in both the House and the Senate. These bills are discussed in further detail below.

#### *A. Legislation in the House of Representatives*

On March 3, 1995, as part of the "Contract with America," the United States House of Representatives passed H.R. 925, "The Private Property Protection Act of 1995," by a vote of 277 to 148. As originally introduced, the bill would have required compensation for any federal action that reduced the value of property by 20% or more. An amendment offered by Rep. Billy Tauzin (D-LA) limited the scope of the bill to require compensation only for those agency actions undertaken pursuant to Clean Water Act section 404 wetlands permits; the Endangered Species Act; the "swampbuster" provisions of the Food Security Act of 1985; and water rights provisions of the Reclamation Act, the Federal Land Policy Management Act, and section 6 of the Forest and Rangeland Renewable Resources Planning Act of 1974.

Because of this limit in scope, this bill, at least in its current form, would not provide a statutory basis for a taking claim by a hydroelectric licensee upon decommissioning.

#### *B. Legislation in the Senate*

A number of private property rights bills have been introduced in the Senate. On March 2, 1995, Senate Majority Leader Robert Dole (R-KS) and 31 co-sponsors introduced S. 605, "The Omnibus Property Rights Act of 1995." This bill is a compilation of four bills that were introduced earlier this year by Senators Dole, Hatch (R-UT), Gramm (R-TX), and Shelby (R-AL). The bill provides two regimes under which hydroelectric facilities would be provided with additional private property protection.

Title II of the Act—"Property Rights Litigation Relief"—provides property owners with a cause of action designed to be more easily proven in a court of law than Fifth Amendment takings claims. Property is defined as all property protected by the Fifth Amendment to the Constitution, applicable federal or state law, or S. 605 itself. Property also includes real property (whether vested or not); rights to use or receive water; rents; issues and profits of land; property rights created by contract or other security interest; any interest deemed property by state law; and interests understood to be property because of custom, usage, common law or mutually reinforcing understandings.<sup>152</sup> The inclusion of property rights defined by state law will give property owners in different states differing capacities for relief from government actions.

Agency action is defined to mean "any action or decision taken by an agency that—(A) takes a property right; or (B) unreasonably impedes the use of property or the exercise of property interests."<sup>153</sup>

Title II would provide a valid, compensable cause of action if the following is demonstrated:

- (1) as the consequence of an action of an agency, or state agency, private property (whether all or in part) has been physically invaded or taken for public use without the consent of the owner; and
- (2)(A) such action does not substantially advance the stated government interest to be achieved by the legislation or regulation on which the action is based;
- (B) such action exacts the owner's constitutional or otherwise lawful right to use the property or a portion of such property as a condition for the granting of a permit, license, variance or any other agency action without a rough proportionality between the stated need for the required dedication and the impact of the proposed use of the property;
- (C) such action results in the property owner being deprived, either temporarily or permanently, of all or substantially all economically beneficial or productive use of the property or that part of the property affected by the action without a showing that such deprivation inheres in the title itself;
- (D) such action diminishes the fair market value of the affected portion of the property which is the subject of the action by *33% percent or more* with respect to the value immediately prior to governmental action; or
- (E) under any other circumstances where a taking has occurred within the meaning of the fifth amendment of the United States Constitution.<sup>154</sup>

"Taking" of private property is defined to include any action "whereby private property is directly taken as to require compensation under the fifth amendment to the United States Constitution or under this Act, including by physical invasion, regulation, exaction, condition, or other means."<sup>155</sup>

Title II allocates the burden of proof for several of the elements of the cause of action it provides. The Government bears the burden of "showing the nexus between the stated governmental purpose of the governmental

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152. S. 605, 104th Cong., 1st Sess. § 203(5) (1995).

153. *Id.* § 203(2).

154. *Id.* § 204(a) (emphasis added).

155. *Id.* § 203(7).

interest and the impact on the proposed use of private property, . . . the proportionality between the exaction and the impact of the proposed use, . . . and that deprivation of value inheres in the title to the property."<sup>156</sup> The property owner bears the burden of proof in establishing a diminution in the value of the property.<sup>157</sup>

A second provision may prevent takings claims from arising. Title IV of the Act—"Private Property Taking Impact Analysis"—is an information forcing provision which may help the property owner interested in bringing a takings claim. In most situations, agencies are directed to "complete a private property taking impact analysis" before taking an action likely to lead to a taking of private property.<sup>158</sup> This analysis shall be made available to the public and, "to the greatest extent possible," be transmitted to the property owner.<sup>159</sup> The agencies are directed not to promulgate rules which would lead to uncompensated takings.<sup>160</sup> The result of these provisions is that only actions which the agency's analysis indicates are not takings will occur. The property owner still may allege, however, that a taking has occurred. The property owner can then rely on either the information gathered by the agency or that gathered privately to demonstrate the taking and rebut those elements which the government must prove.

S. 605 would greatly enhance the ability of hydroelectric owners to respond to government actions by filing takings claims. There are three critical alterations to present takings jurisprudence that the Act provides. First, it lists a broad range of property interests which can be taken, then adds any property interests deemed valid under state law. Second, the Act places the burden of proof as to several of the more difficult elements on the Government. Third, the Act lowers the standard by which the value of the property must be diminished to 33% or more. In addition, the Act would not infringe on any claim brought under present takings doctrines.<sup>161</sup>

If passed, S. 605 would require the FERC to perform a taking impact analysis prior to a relicensing decision. If the FERC determined that no taking would occur, then it could go ahead with its decision. The licensee then may bring a taking claim if the licensee could show a reduction in value of 33% or more as a result of the FERC's action.

## VI. CONCLUSION

Although the FPA specifically defines the range of outcomes that can occur at the time of license renewal, the FERC, in its Policy Statement, has asserted the authority to add two more: (1) license denial and removal of the project; and (2) license renewal under uneconomic conditions. The FERC's implementation of either of these options may be challenged on a number of grounds: (1) that the FERC lacks statutory authority to require

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156. *Id.* § 204(c)(1).

157. S. 605, 104th Cong., 1st Sess. § 204(c)(2) (1995).

158. *Id.* § 403(a)(1)(B).

159. *Id.* § 403(c).

160. *Id.* § 404(a).

161. *Id.* § 204(a)(2)(E).

decommissioning or continued operation at an economic loss; (2) that such actions by the FERC would be a breach of the license as a contract; and (3) that either uncompensated decommissioning or issuing a new license with uneconomic conditions would be an unconstitutional taking under the Fifth Amendment, thus requiring payment of just compensation to the licensee. These issues have not yet been tested in the courts because the FERC's decommissioning policy is new and the FERC has just begun to apply it. Legislative proposals protecting property rights have been introduced in the Senate which, if passed, could limit the FERC's future decommissioning activities.