

REGULATORY

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Legal ALERT!

D.C. Circuit Reverses FERC's Federal Power Act Order in Hudson River-Black River Regulating District

For nearly three-quarters of a century, the Hudson River-Black River Regulating District (the "District") and its predecessors have owned and operated the Conklingville Dam (the "Dam"). The Dam was constructed to regulate water flow on the Sacandaga River, a tributary of the Hudson River in upstate New York. Pursuant to New York's Environmental Conservation Law, the District is authorized to recover its costs of building and operating the Dam through an annual assessment on the owners of river front property benefiting from the regulating services that facility provides, including the owners of several hydroelectric facilities licensed by the Federal Energy Regulatory Commission ("FERC") and its predecessor agency the Federal Power Commission ("FPC").

In 1963, Niagara Mohawk Power Corporation ("Niagara Mohawk") received an original license from the FPC to construct a power house and generating facilities at the base of the Dam. The facility is known as the E. J. West Generating Station. This license specifically excluded the Dam from the facilities subject to that license¹. However, in its review of Niagara Mohawk's request to extend the E. J. West Project license in 1992, FERC ruled that the Dam *was* included within the "unit of development" comprising the E. J. West Project and, accordingly, that the District was required to obtain a license from the FPC for the Dam². This license was ultimately issued to the District by order dated September 22, 2002³.

1. Albany Engineering's Complaint

Albany Engineering Corporation ("AEC") is the licensee for the Mechanicville Hydroelectric Project, which is located downstream of the Dam. On June 25, 2006, AEC filed a complaint with FERC contending that the District has been without authority under New York law assessing AEC for the regulating benefits provided by the Dam. According to AEC, section 10(f) of the Federal Power Act ("FPA")⁴ instead provides the exclusive means by which the owner of a facility licensed under the FPA may assess charges on other FPA licensed facilities. FPA § 10(f) provides:

Whenever any licensee hereunder is directly benefited by the construction work of another licensee . . . the licensee so benefited shall reimburse the owner of such reservoir or other improvements for such part of the annual charges for *interest, maintenance, and depreciation* hereon as the Commission may deem *equitable*. The proportion of such charges to be paid by any licensee shall be determined by the Commission. . .

16 U.S.C. § 803(f) (emphases added). AEC contended that the District was in violation of the requirements of FPA § 10(f) for two reasons: First, the District's charges for "interest, maintenance and depreciation" have not been found by FERC to be "equitable." Second, the District also sought to impose charges on AEC designed to recover the costs of operating the Dam, which AEC claimed were not charges for "interest, maintenance and depreciation," authorized under FPA § 10(f).

2. FERC's Decision

In its order dated December 22, 2006⁵, FERC found that FPA § 10(f) enables the upstream dam to recoup an equitable share of the "interest, maintenance and depreciation" costs incurred in creating "headwater benefits" from downstream hydroelectric projects.

¹ *Niagara Mohawk Power Co.*, 29 FPC 1290, 1291 n.2 (1963).

² See letter to Niagara Mohawk dated August 27, 1992, from the Director, Division of Project Review, Office of HydroPower Licensing.

³ *Hudson River-Black River Regulating District*, 100 FERC 61,319 (2002).

⁴ 16 U.S.C. § 803(f) (2006).

⁵ *Fourth Branch Associates (Mechanicville) v. Hudson River - Black River Regulating District*, 117 FERC 61,321 (2006), *reh' denied*, Order Granting Rehearing for further Consideration, FERC Project No. 12252-024 (Feb. 21, 2007)

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FERC agreed with AEC's contention that the District could not impose any charges for "interest, maintenance and depreciation" of the Dam on AEC unless and until those charges had been approved by FERC as required by FPA § 10(f).

FERC went on to rule, however, that nothing in the FPA should be construed as preempting the District's power under New York law to charge downstream hydroelectric projects for any costs incurred in operating the Dam other than "interest, maintenance and depreciation." Because neither AEC nor the District had specifically requested that FERC undertake a detailed review of the "interest, maintenance and depreciation" costs that the District could recover from AEC under FPA § 10(f), and in light of FERC's finding that the District was free to impose charges to recover other costs under New York law, FERC rejected AEC's request for an order prohibiting the District from assessing any charges on AEC not approved by FERC.

3. D. C. Circuit's Order Reversing FERC's Decision

On November 28, 2008, the United States Court of Appeals for the District of Columbia Circuit reversed FERC's determination that District retained the authority under New York law to charge AEC and other FERC licensees for costs incurred in operating the Dam other than "interest, maintenance and depreciation."⁶ The Court of Appeals agreed with AEC that in adopting FPA § 10(f), the United States Congress had "occupied the field," preempting any state regulation of such charges and making § 10(f) the exclusive means by which the District could recover any part of the costs of operating the Dam from AEC and other FERC licensees.

The Court of Appeals held that FERC's interpretation of the FPA was flawed because the legislative history of the FPA makes clear that § 10(f) was meant to provide for limited reimbursement, which requires the downstream licensees to contribute to the cost of upstream project only to the extent of the benefits received. Therefore, a further assessment by the District was not required. Also, if such a dual authority over headwater assessments between FERC and the states were allowed, it would result in the application of different cost allocation methodologies which would undermine the congressional intent to create a comprehensive scheme of hydropower development.

As a result of these defects, among others, the Court reversed FERC's decision and held that FPA § 10(f) preempts all state headwater benefit assessments materially changes the context for FERC's consideration.

4. Practical and Political Impacts of the Decision

The Court's order will have several immediate impacts on the District. First, the District will be forced either to negotiate rates for headwater benefits with AEC and other hydroelectric projects along the Sacandaga and Hudson Rivers or to bring a rate case at FERC to prove its costs and establish an equitable allocation of those costs among affected hydroelectric facilities. Second, the District will also be forced to justify all charges imposed from September 22, 2002 on and to refund any amounts it cannot justify.

In addition, this case may ultimately force the District to increase its charges to municipalities and other beneficiaries of the Dam other than FERC-licensed hydroelectric facilities. According to evidence submitted by AEC in the proceedings before FERC, the District has historically assessed approximately 95 percent of its costs on hydroelectric projects.⁷ Any costs of the District which cannot be recovered in rates approved by FERC under FPA § 10(f) – whether because they involve costs other than interest, maintenance and depreciation or because they exceed the level of interest depreciation and maintenance costs allowed by FERC – will need to be recovered from other beneficiaries unless the District can develop alternate sources of funding. Development of such alternate sources of funding would be difficult under any circumstances, but will be particularly difficult in light of New York's current fiscal challenges.

⁶ *Albany Engineering v. Hudson River-Black River Regulating District* No. 07-1162 (D.C. Cir. 2008).

⁷ Complaint against Hudson River-Black River Regulating District Regarding Unauthorized Assessments of Headwater Benefits Charges, July 25, 2006, p. 13 & Attachment E, Report by Gomez & Sullivan, Fourth Branch Associates (*Mechanicville*) v. *Hudson River - Black River Regulating District*, Docket No. EL06-91-000, Project No. 12252.023.

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