

BACKGROUND

2. The following history is relevant to the issues addressed in this order. In 1867, the Illinois legislature authorized L&W to build and maintain a dam across the Illinois River at Marseilles, together with a navigation canal along the south bank³ and, on the north bank, two intakes, one each for the north and south power canals (also called raceways, head races, or channels), into which an amount of surplus water is diverted for private power purposes. We are concerned here only with the north power canal.

3. In 1911, Illinois Power Company built the Marseilles Hydropower plant at the end of the north power canal, and operated the project with water leased from L&W.

4. In 1933, as part of its Illinois Waterway Plan, the Corps replaced L&W's dam across the Illinois River with a higher dam. In exchange for L&W's consent to the Corps' acquisition and removal of the existing dam and headgates, the Corps agreed to install gates at the north and south power canals in a manner that would preserve the canals' historic levels and the Marseilles Hydropower Plant's historic power generation. Specifically the agreement between the Corps and L&W stated that the Corps' use, modification, or removal of L&W's dam and headgates "shall not injure, jeopardize, or destroy the normal power capacity of" L&W.⁴

5. Illinois Power's water contract with L&W consisted of a 90-year indenture (lease) for water (until 2001), with an option to renew for an additional 90 years (until 2091). Illinois Power operated the Marseilles Hydropower Plant until 1988, when it decommissioned the plant.⁵ In 1999, Hydro Power's sister companies

³The navigation canal leads to a lock, by which marine traffic bypasses rapids below the dam.

⁴See Hydro Power's request for rehearing, as supplemented (n. 2, *supra*), Exhibit Ib (December 22, 1931 letter from the Corps' District Engineer Weeks to L&W, at 5); and Exhibit II (L&W's December 29, 1931 letter to District Engineer Weeks, at 3).

⁵See the Environmental Assessment issued in this proceeding on March 25, 2003, at 14.

bought the plant from Illinois Power and succeeded to that company's interests under the water indenture.⁶

6. The project licensed by the Director's November 28, 2003 Order consists of an existing powerhouse; existing and proposed generating units; the 2,730-foot-long North Channel Headrace (canal) that conveys water from the headgate to the powerhouse; a new trash rack; and appurtenant facilities.⁷

DISCUSSION

A. L&W's Rehearing Request

7. In its rehearing request, L&W points out that it owns the water rights at the site; owns and operates the north power canal system; and, pursuant to a 1931 contract with the Corps, operates the Corps' headgate to the north canal.⁸ L&W argues that the Commission erred in issuing a license to Hydro Power, which it asserts does not have, and cannot obtain, the water rights necessary for the project.⁹ L&W disputes Hydro Power's claim to the water lease that was previously held by Illinois Power, stating that it terminated the lease in July 2001, based on what it asserts was a material breach of the contract by Illinois Power

⁶See Hydro Power's July 15, 2002 filing at n. 1.

⁷See 105 FERC ¶ 62,131 at ordering paragraph B.

⁸L&W sought to obtain a license for the Marseilles Hydropower Plant, but failed to meet a critical filing deadline. Its attempt to reverse the rejection of the late filing was unsuccessful. See *Marseilles Land and Water Co. v. FERC*, 345 F.3d 916 (D.C. Cir. 2003).

⁹In its filing of September 16, 2002 (at 1), in this proceeding, L&W stated that property needed by Hydro Power but owned by L&W "is not available to [Hydro Power] on a volitional basis." The filing stated further (*id.*): "While [Hydro Power] understands that taking property through eminent domain is its ultimate option, [Hydro Power] has not considered or acknowledged the costs of this acquisition in its license application financial model."

and Hydro Power. L&W states that the contract issue is in court,¹⁰ but asserts, without elaboration, that in any event Hydro Power cannot obtain the needed water rights, or the right to operate the Corps' headgate, by means of eminent domain.

¹⁰On August 5, 2002, the U.S. Court of Appeals for the Seventh Circuit issued an opinion on appeal from a U.S. Federal District Court involving the contract dispute between Hydro Power and L&W. *Marseilles Hydro Power, LLC v. Marseilles Land and Water Co.*, 299 F.3d 643 (7th Cir. 2002). The opinion summarized the facts as follows (299 F.3d at 645):

A contract between the parties' predecessors required the owner of the [hydroelectric] plant to pay rent to the owner of the canal and required the latter to keep the canal in good repair. . . . [T]he current owner of the plant, that is, the power company [Hydro Power], decided to put the plant back into service and . . . feared that the canal's wall was about to collapse. The canal company [L&W] refused to repair it, and so the power company brought this suit to enforce the canal company's duty under the contract and moved for a injunction; but before the motion could be heard, the canal wall collapsed. The canal company counterclaimed for the rent due under the contract, rent that the power company refused to pay until the canal was repaired.

After a bench trial, the District Court judge awarded judgment for the power company both on its complaint and on the canal company's counterclaim, and authorized the power company to enter upon the canal company's property in order to repair the canal wall and to obtain a lien on the property for the cost of the repair.

L&W appealed, claiming the right to a jury trial. The appellate court agreed that L&W was entitled to a jury trial, and reversed and remanded the case to the District Court. In so doing, it suggested that the District Court stay the remanded proceeding until the FERC's licensing proceeding concluded, since if Hydro Power's license application were denied, the contract litigation could be mooted, and if the application were granted, the Commission would might have its own ideas about how best to repair the canal wall. 299 F.3d at 650-52. The District Court took the appellate court's suggestion, and stayed the remanded proceeding. *Marseilles Hydro Power, LLC v. Marseilles Land and Water Co.*, 2003 U.S. Dist. LEXIS 1652 (N.D. Illinois, February 4, 2003).

8. L&W's final argument is that, were Hydro Power indeed able to obtain water rights via eminent domain, then the Commission's issuance of the license to Hydro Power "discriminatorily favored" the rights of Hydro Power over those of L&W, and violated section 27 of the Federal Power Act (FPA) by "unduly influencing" the ongoing water rights litigation. L&W's "undue influence" argument is stated as follows:¹¹

Assuming for the moment that [Hydro Power] would, by virtue of its license, seek to condemn [L&W's] water rights, by issuing the license, the Commission has unduly influenced the ongoing litigation. Under this scenario, even if [L&W] wins the litigation and owns the water rights and wants to use those water rights for its own purposes or desires to sell the rights to an industrial concern in the area for process purposes, the [power company] may seek to usurp [L&W's] rights. At a minimum, the Commission should clarify that it does not intend to affect the outcome of the litigation over the water rights in the state court.

9. Section 27 of the FPA, 16 U.S.C. § 821, states:

That nothing [in Part I of the FPA] shall be construed as affecting or intending to affect or in any way to interfere with the laws of the respective States relating to the control, appropriation, use, or distribution of water used in irrigation or for municipal or other uses, or any vested right acquired therein.

10. The Commission does not adjudicate water rights: that is a State function. As to whether a licensee can obtain water power rights by means of eminent domain, we note the Supreme Court's statement that section 27 simply establishes a right of compensation for any water rights a licensee takes for project purposes.

¹¹ Rehearing request at 5.

See FPC v. Niagara Mohawk Power Corp., 347 U.S. 239 (1954).¹² It therefore appears that a licensee can, upon payment of just compensation,¹³ obtain the necessary project water rights by means of the eminent domain power conferred by section 21 of the FPA, 16 U.S.C. § 814.¹⁴

11. Turning to L&W's "undue influence" argument, we fail to see how, if L&W wins the water rights litigation, it can demonstrate that the Commission's license order "unduly influenced" that litigation. Nor do we think that a State court's determination of which party holds a disputed water right would be influenced by how that right may change hands in the future. We note moreover

¹²The Federal Power Commission (FPC) was the FERC's predecessor agency. The Court stated, 347 U.S. at 251 (footnote omitted):

The [FPA Part I] treats usufructuary water rights like other property rights. While leaving the way open for the exercise of the federal servitude and of federal rights of purchase or condemnation, there is no purpose expressed to seize, abolish or eliminate water rights without compensation merely by force of the Act itself.

See also Portland General Electric Co. v. FPC, 328 F.2d 165, 176 (9th Cir. 1964) ("The only purpose of section 27 is to preserve to holders of state-conferred water rights a right to compensation if those rights are taken or destroyed as an incident to the exercise by another, of a license granted by the Commission").

¹³See, e.g., FPC v. Tuscarora Indian Nation, 362 U.S. 99, 113 (1960).

¹⁴Section 21 states in pertinent part:

That when any licensee can not acquire by contract or pledges . . . the right to use or damage the lands or property of others necessary to the . . . operation of any [project works], . . . it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such land or other property may be located, or in the State courts. . . .

Whether the action is filed in Federal District or State court, the State law is applied. See Georgia Power Co. v. 138.30 Acres of Land, 617 F.2d 1112 (5th Cir. 1980), cert. denied, 450 U.S. 936 (1981).

that, if Hydro Power were to find it necessary to file an eminent domain action against L&W to obtain the right to use the water power in the north power channel, L&W would receive just compensation for such right, as determined under State law.¹⁵

12. Finally, there is L&W's assertion that issuing the license to Hydro Power "discriminatorily favored" Hydro Power's rights over those of L&W. Federal eminent domain authority under the terms of section 21 is made available to every entity that receives a hydroelectric license, which can be issued only on a finding that the project being licensed meets the FPA's public interest standard.¹⁶ The FPA thus reflects the legislators' judgment that the construction and operation of qualifying hydroelectric projects warrants the purchase or condemnation of necessary property rights, on payment of just compensation.

13. In view of the above, we deny L&W's request for rehearing.

B. Hydro Power's Rehearing Request

1. Federal Dam Use Charges

14. Section 10(e)(1) of the FPA, 16 U.S.C. § 803(e)(1), directs the Commission to fix a reasonable annual charge for a licensee's use of a Federal dam or other structures owned by the United States.¹⁷ Article 201(C) of the license issued to Hydro Power states that, effective as of the date of commencement of project construction, the licensee shall pay annual charges to recompense the United States "for utilization of surplus water or water power from a government dam, a

¹⁵See n. 12, *supra*.

¹⁶See FPA sections 10(a)(1) and 4(e), 16 U.S.C. §§ 803a(1), 797(e).

¹⁷Section 10(e) also requires a licensee to pay annual charges, in an amount to be fixed by the Commission, for the purpose of reimbursing the United States for the costs of administering Part I of the FPA, *i.e.*, the Commission's hydropower program. Hydro Power does not contest this charge, which is provided for in license Article 201(A).

reasonable amount as determined in accordance with the provisions of the Commission's regulations in effect from time to time."¹⁸

15. Citing to the above-described history of the Marseilles Dam, Hydro Power argues that, by the terms of the 1931 agreement between the Corps and L&W, the Corps dam that replaced the private dam conferred no benefit to the Marseilles Hydropower Plant, and that therefore the license issued by the Director should not have required the payment of annual charges for the project's use of the Corps dam (i.e., water power created by the Corps dam).

16. Hydro Power's claim to a waiver of Federal dam use charges rests on its status as successor-in-interest to the long-term lease of the water power in the north power canal. The issue of whether that lease is still in effect is in abeyance before a Federal District Court pending the conclusion of this licensing proceeding (see above, P 7 and n.10).

17. If the final court decision holds that Hydro Power's lease is in effect, then we agree that Federal dam use charges should be waived for the Marseilles Project. See City of Kaukauna, Wisconsin v. FERC, 214 F.3d 888 (7th Cir. 2000), which dealt with the same basic issue in a case involving charges pursuant to FPA section 10(f) for headwater benefits from a Federal dam. While section 10(e) charges apply to licensed projects benefited by their location at the site of a Federal dam, section 10(f) charges apply to licensed projects benefited by their location downstream of a Federal dam.¹⁹ In Kaukauna, the court held that the Commission cannot assess headwater benefit charges against a licensee who

¹⁸105 FERC ¶ 62,131 at 64,288-89. The Commission's regulations for Federal dam use charges are found at 18 C.F.R. § 11.3. In 1986, Congress established the charges; see FPA section 10(e)(1), final proviso.

¹⁹Section 10(f)(1), 16 U.S.C. § 803(f)(1), states in pertinent part:

That whenever any licensee hereunder is directly benefited by the construction work of another licensee, a permittee, or of the United States of a storage reservoir or other headwater improvement, the Commission shall require as a condition of the license that that 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 thereon as the Commission may deem equitable. . . .

already owns the rights to the water power created by an upstream project. The court stated (214 F.3d at 893):

While FERC clearly has the authority to assess water-power-related charges under both § 10(e) and § 10(f) of the FPA, . . . FERC cannot assess charges for the use of water or water rights to which a party has a vested right under state law. . . .

18. In light of the pendency of the court case on the status of the water power lease, we deny rehearing of Article 201(C), governing annual charges for use of a Federal dam. However, if and when there is issued a final court decision establishing that Hydro Power holds a valid lease for the water power in the north power channel, the licensee may renew its application to amend the license by deleting Article 201(C).

2. Federal Land Use Charges

19. Pursuant to FPA section 10(e)(1), the Commission also assesses annual charges for a licensee's use of Federal lands. Article 201(B) of the Marseilles Project license requires Hydro Power to pay annual charges to recompense the United States for the project's use of 0.6 acre of Federal land.²⁰

20. Hydro Power objects to this charge. It points out that the 0.6 acre of Federal land in question is in fact occupied by the Corps' North Channel Headrace gates, and asserts that the land is thus properly considered "adjoining or pertaining to Government dams or other structures," and as such is, pursuant to section 11.2 of the Commission's regulations, exempt from Federal land use charges.²¹

21. We agree that Hydro Power should not be assessed Federal land use charges, for one or both of two reasons, depending on what a clarification of the facts reveals. Section 10(e)(1) of the FPA and section 11.2(a) of the

²⁰105 FERC ¶ 62,131 at 64,288-89.

²¹The Commission's regulations for Federal land use charges are found at 18 C.F.R. § 11.2. Section 11.2(a) states that the Commission will fix "[r]easonable annual charges for recompensing the United States for the use, occupancy, and enjoyment of its lands (other than lands adjoining or pertaining to Government dams) or its other property"

Commission's regulations deal with charges for a project's "use, occupancy, and enjoyment" of Federal lands. In this context, therefore, Federal lands "adjoining or pertaining to" Federal dams refer to lands occupied by the licensed project; *i.e.*, within the project boundary.²² Thus, if the 0.6 acre in question is within the project boundary, as Hydro Power's license application stated,²³ then we agree it is Federal land "adjoining or pertaining to Government dams or other structures" and should not be the subject of Federal land use charges.

22. However, Hydro Power also states, in its license application and on rehearing, that the 0.6 acre is occupied by the Corps' headrace gates, which, as Federal property, cannot be part of the licensed project. Thus, if the 0.6 acre is completely occupied by the Corps gates, then the gates, and the Federal land beneath them, must be excluded from the project boundary, at which point no question of Federal land use charges will arise. If the 0.6 acre is occupied in part by the Corps gates and in part by project works (*e.g.*, a portion of the north power canal), then Hydro Power must exclude the portion of the Federal land occupied by the Corps gates, so that the Commission can adjust the acreage on which federal land use charge will be calculated. In all events, while we grant rehearing on this issue, we are requiring Hydro Power to file revised project boundary exhibits clearly showing the exclusion of Federal works and the inclusion of any Federal land occupied by the project.

3. Free Power for Corps Navigation Facilities

23. Section 11(c) of the FPA, 16 U.S.C. § 804(c), provides:

That if the dam or other project works are to be constructed across, along, or in any of the navigable waters of the United States, the Commission may, insofar as it deems the same reasonably necessary to promote the present and future needs of navigation and consistent with a reasonable investment cost to the licensee, include in the license any one or more of the following provisions or requirements:

* * *

²²See, *e.g.*, Idaho Water Resource Board, 84 FERC ¶ 61,146 at 61,792 n. 21.

²³March 14, 2001 license application at p. 1-4.

(c) That such licensee shall furnish free of cost to the United States power for the operation of such navigation facilities, whether constructed by the licensee or by the United States.

When issuing a license for a project on a navigable stream, whether for an existing dam or a dam to be constructed, the Commission includes in the license a standard article requiring the licensee to furnish free power for Federal navigation facilities.²⁴

24. Article 24 of the Marseilles Project license states:²⁵

The Licensee shall furnish power free of cost to the United States for the operation and maintenance of navigation facilities in the vicinity of the project at the voltage and frequency required by such facilities and at a

²⁴See, e.g., the current standard license articles, published at 54 FPC 1792-1928 (1975): Form L-3, Terms and Conditions of License for Constructed Major Project Affecting Navigable Waters of the United States, Article 24 (54 FPC at 1824); and Form L-4, Terms and Conditions of License for Unconstructed Major Project Affecting Navigable Waters of the United States, Article 24 (54 FPC at 1831).

There is very little Commission case law on FPA section 11, and only one court decision, *Portland General Electric Co. v. FPC*, 328 F.2d 165 (9th Cir. 1964). That decision remanded the case to the Commission without reaching the issue of whether the term “to be constructed” means that section 11 applies only to licenses authorizing the construction of a dam, or whether, as the Commission had held (28 FPC 165 (1962); reh’g denied, 29 FPC 126 (1963)), section 11 applies to dams to be constructed after the enactment in 1920 of what is now Part I of the FPA. The court remanded the matter because at oral argument the Commission’s lawyer had advanced an alternative legal theory not contained in the Commission orders on review. On remand, the licensee and the Commission settled the matter (32 FPC 356 (1964)), and it appears the Commission has never revisited the issue. Hydro Power does not challenge the applicability of section 11 to its license.

²⁵See Form L-5 (October 1975), entitled “Terms and Conditions of License for Constructed Major Project Affecting Navigable Waters and Lands of the United States,” published at 54 FPC 1832, 1834 (1975), and incorporated by reference in the Project No. 12020 license, 105 FERC ¶ 62,131 at 64,288, ordering paragraph D.

point adjacent thereto, whether said facilities are constructed by the Licensee or by the United States.^[26]

25. Hydro Power notes that section 11 does not compel the Commission to require a licensee to provide free power for federal navigation works; rather, such requirement can come only after a showing that the free power is “reasonably necessary to promote the present and future needs of navigation and consistent with a reasonable investment cost to the licensee.” Hydro Power argues that no such showing has been made in this proceeding. It asserts that free power cannot be called “reasonably necessary” at the Marseilles lock and dam, inasmuch as these works have been in operation since the 1930s, and the newly licensed hydroelectric project will not affect them. It also argues that the provision of free power is not “consistent with a reasonable investment cost to the licensee,” in light of the estimated total annual cost of \$17,500.²⁷ Finally, it considers a requirement to provide free power from this project to be “wholly inappropriate,” given the Corps’ 1931 commitment to preserve the project’s normal power capacity.

26. It appears that the last, and perhaps only, case dealing with the Commission’s burden of proof under section 11 was Portland General Electric Company, in the mid-1960s (see n. 24, supra). On appeal of the Commission orders in that proceeding, the court remanded the case, stating that the project license’s requirement that the licensees provide free power to existing Federal navigation facilities:

Imposes a present obligation on [the licensees] to provide the electric energy necessary for operation of those facilities. Yet the Commission has not found, . . . as required by section 11, whether the operation of such navigation facilities is reasonably necessary to promote the present and future needs of navigation, and whether the financial burden thus imposed

²⁶Federal dam use charges are calculated based on a project’s gross energy production “less the energy provided free of charge to the Government.” 18 C.F.R. § 11.3(c)(1). This refers to free power for navigation purposes, *i.e.*, under section 11 of the FPA. See Annual Charges for Use of Government Dams and Other Structures Under Part I of the Federal Power Act, Order No. 379, 49 Fed. Reg. 22,770 (June 1, 1984), FERC Stats. & Regs. ¶ 30,569 at 30,954 (May 24, 1984).

²⁷Rehearing request at 10.

on [the licensees] is consistent with a reasonable investment cost to the licenses.

Upon the remand, . . . the Commission will have an opportunity to make appropriate findings as to these matters which, depending on their nature, will establish a factual basis for the imposition of such an obligation or establish that no such obligation may be imposed.^[28]

27. A September 4, 2002 filing by the Corps in this proceeding claims that it is entitled to free power for its navigation works at Marseilles, and asserts that the requirement is reasonably necessary and at a reasonable cost, but provides no support for the assertion.

28. Hydro Power's estimate of \$17,500 as the cost of providing free power was based on giving the Corps 500 megawatt-hours (MWH), at a cost to Hydro Power of \$35/ MWH. The project's estimated average generation is about 34,000 MWH,²⁹ of which 500 MWH to the Corps would be 1.47 percent. This would appear to be a minimal cost, although we do not know the net revenues from the sale of project power. In any event, we find, based on the record in this proceeding, that the licensee's provision of free project power to the Corps' navigation facilities is not reasonably necessary to promote the present and future needs of navigation. We therefore grant rehearing on this issue and will delete the free-power requirement.

The Commission orders:

(A) The March 29, 2004 motion to supplement the December 23, 2003 rehearing request filed by Marseilles Hydro Power, LLC, is granted.

(B) The December 29, 2003 rehearing request filed by Marseilles Land and Water Company is denied.

²⁸Portland General Electric Co. v. FPC, supra, 328 F.2d at 175 (footnote omitted). It appears the court misstated the showing to be made, which is the necessity, not of the operation of the navigation facilities, but of the provision of free power for such operation. The error does not, however, undermine the principle being stated.

²⁹See 105 FERC ¶ 62,131 at P 32.

(C) The December 23, 2003 rehearing request filed by Marseilles Hydro Power, LLC, is granted as set forth below and is denied in all other respects.

(D) Article 24 of the license issued on November 28, 2003, for the Marseilles Hydroelectric Project is deleted.

(E) Article 201(B) of the license issued on November 28, 2003, for the Marseilles Hydroelectric Project is deleted, and Article 201(C) is redesignated Article 201(B).

(F) Within 60 days of the date of issuance of this order, Marseilles Hydro Power, LLC, shall file with the Commission a revised Exhibit G, clearly showing, if need be with the use of enlarged drawings, the location of the 0.6 acre of Federal land; the location of the Corps' North Channel Headrace gates; and the location of the project boundary, including therein only such Federal land, if any, as is occupied by any project work or facility.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.