UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Fourth Branch Associates (Mechanicville) Docket No. EL06-91-000
Project No. 12252-023

v.

Hudson River – Black River Regulating District

ORDER ON COMPLAINT

(Issued December 22, 2006)

1. On July 25, 2006, Fourth Branch Associates (Mechanicville) (Fourth Branch) filed a formal complaint against Hudson River - Black River Regulating District (District) pursuant to Rule 206 of the Commission's Rules of Practice and Procedure[1] and section 306 of the Federal Power Act (FPA).[2] Fourth Branch alleges that the District is improperly assessing it charges under New York state law for headwater benefits that Fourth Branch's Mechanicville Project No. 6032 receives from the operation of the District's upstream Great Sacandaga Lake Project No. 12252. Fourth Branch argues that any charges for such benefits are governed by section 10(f) of the FPA[3] rather than by state law. Fourth Branch requests relief as specified below. The District filed an answer to the complaint. We are granting relief to the extent discussed herein.

Background

2. Great Sacandaga Lake is impounded by the Conklingville Dam on the Sacandaga River, a tributary of the Hudson River. The dam and lake were constructed by

[1] 18 C.F.R. § 385.206 (2006).

[2] 16 U.S.C. § 825(e) (2000).

[3] 16 U.S.C. § 803(f) (2000).

New York to provide flood control and summer flow augmentation for communities bordering the Hudson River below the Sacandaga River confluence.[4] These facilities, owned by the State of New York, are managed by the District, a state agency authorized to operate and maintain various storage reservoirs in the state.[5] The District's operation of Great Sacandaga Lake controls flow through the generating facilities of the E.J. West Project No. 2318 and the Sacandaga River downstream through its confluence with the Hudson River.[6] Releases from the dam also affect hydroelectric projects and other industrial facilities, municipalities, and natural resources downstream on the Sacandaga and below the confluence of the two rivers.[7]

3. In 1992, Commission staff determined that Conklingville Dam and Great Sacandaga Lake were part of the unit of development of the E.J. West Project, owned at that time by Niagara Mohawk Power Corporation (Niagara Mohawk), and therefore were required to be licensed.[8] Initially, Niagara Mohawk filed an amendment to its then-pending application for a new license for the E.J. West Project to include these facilities. This project and three other Niagara Mohawk Projects on the Sacandaga or Hudson Rivers with pending relicense applications were transferred to Erie Boulevard Hydropower, L.P. (Erie) in 1999. In April 2000, Erie and the District filed an amendment to the E.J. West application to add the District as a co-applicant.

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[4] *See Erie Boulevard Hydropower, L.P.*, 100 FERC ¶ 61,321 at P15 (2002).

[5] Fourth Branch's complaint states that the District was created in 1959, pursuant to N.Y. Envtl. Conserv. L. § 15-2137, through consolidation of the Hudson River Regulating District and the Black River Regulating District. The Hudson River Regulating District was organized in 1922 under N.Y. Envtl. Conser. Law §§ 15-2101 *et seq*.

[6] *Hudson River-Black River Regulating District*, 100 FERC ¶ 61,319 at P 5 (2002).

[7] *Erie Boulevard Hydropower, L.P.*, 100 FERC ¶ 61,321 at P15 (2002).

[8] Section 3(11) of the FPA, 16 U.S.C. § 793(3)(11) (2000), provides that a project includes a complete unit of improvement or development, consisting, as pertinent here, of a powerhouse, all water conduits, and all dams that are part of that unit, as well as all storage, diverting, and forebay reservoirs directly connected therewith. While all such project works must be licensed, they need not all be brought under one license or licensed to the same licensee. *See, e.g., Union Water Power Company*, 68 FERC ¶ 61,180 (1994).

4. On September 25, 2002, we issued new licenses to Erie for its four projects and an original license to the District for the Great Sacandaga Lake Project, comprising principally Great Sacandaga Lake and Conklingville Dam.[9] We also issued an order approving an offer of settlement filed by Erie in April 2000 relating to all of the applications.[10] Signatories to the settlement offer included Erie, the District, Niagara Mohawk, the New York Department of Environmental Conservation, the U.S. Department of the Interior, and various environmental and recreational groups.[11]

5. In our order approving the offer of settlement, we found that operation of the Great Sacandaga Lake Project and the four Erie projects would affect generation at several other downstream projects on the Hudson River not covered by the settlement offer. As we noted, these downstream projects operate essentially in a run-of-river mode, so that their generation depends on the magnitude and timing of discharges from Great Sacandaga Lake and the Erie projects.[12] The record in the licensing proceedings suggested that most of the downstream projects would experience a net increase in generation.[13]

6. The additional electric generation that results at a downstream project from regulation of the flow of the river by an upstream headwater project is referred to as

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[9] *Hudson River - Black River Regulating District*, 100 FERC ¶ 61,319 (2002) and *Erie Boulevard Hydropower, L.P.*, 100 FERC ¶¶ 61,317, 61,318, 61,320, and 61,322 (2002). In filing the amendment, Erie and the District had in fact requested the issuance of separate licenses, with separate project numbers, for Erie's E.J. West powerhouse and generating facilities and the District's dam and reservoir.

[10] *Erie Boulevard Hydropower, L.P.*, 100 FERC ¶ 61,321 (2002). This order contains a fuller description of the history of the proceedings.

[11] A complete list of the signatories is found in the order approving the offer of settlement, 100 FERC ¶ 61,321 at n.12.

[12] *Erie Boulevard Hydropower, L.P.*, 100 FERC ¶ 61,321 at P 47 (2002). At n.33, we listed the 15 projects, including the four Erie projects and two then-unconstructed projects, that are located below the Great Sacandaga Lake Project on the Sacandaga and Hudson Rivers and are influenced by those flow releases.

[13] *Id*. at n.35.

headwater benefits.[14] These benefits are usually attributable to increasing or decreasing the release of water from a storage reservoir. Section 10(f) of the FPA provides, as to headwater benefits, that, whenever a licensee is directly benefited by the construction work of another licensee, a permittee, or the United States of a storage reservoir or other headwater improvement, the Commission shall require as a condition of the license that the licensee reimburse the owner of such reservoir or other improvement for such part of the annual charges for interest, maintenance, and depreciation thereon as the Commission may deem equitable.

7. Section 10(f) provides that the proportion of such charges to be paid by any licensee shall be determined by the Commission. We include in each license an article requiring the licensee to reimburse the owner of any headwater improvement for headwater benefits at the time those benefits are assessed, as well as a standard article reserving our authority to assess headwater benefit charges. Section 11.11 of the Commission's regulations[15] provides a methodology (the "energy gains" method) for the Commission to calculate headwater benefits charges, but section 11.14(a)(1) of the regulations[16] allows owners of downstream and headwater projects to negotiate a settlement for headwater benefits charges and file it for Commission approval in lieu of an investigation conducted by the Commission.

8. Section 8.4 of the offer of settlement filed in the license proceedings notes that the District is reimbursed for operations and maintenance expenses associated with operation of the dam and the lake, through charges for benefits to downstream hydroelectric facilities and charges to municipalities for flood protection benefits.[17] Section 8.4 provides that the signatories to the settlement offer "understand that the assessment of charges is done by the Board of the Regulating District in a process defined within Article 15, Title 21 of the New York State Conservation Law." It states further that the

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[14] *See* section 11.10(a)(2) of the Commission's regulations, 18 C.F.R. § 11.10(a)(2) (2006).

[15] 18 C.F.R. §11.11 (2006).

[16] 18 C.F.R. §11.14(a)(1) (2006).

[17] Section 8.4 lists the specific hydroelectric beneficiaries and municipalities in question. It also lists as a source of reimbursement charges to Erie for the E.J. West Project's use of head and water at the Conklingville Dam. As the complaint and the District's response clarify, these charges are collected pursuant to a hydroelectric site agreement.

signatories recognize that conditions have changed since benefits were originally assessed and that, pursuant to Title 21, the District has initiated a reassessment procedure, which it would attempt to complete by June 30, 2000. Section 8.4 of the offer of settlement provides:

> This Settlement Offer recognizes the statutory right of the Regulating District to implement changes to its benefits assessments through appropriate Regulating District procedures, which procedures are to be outside the jurisdiction of any new licenses for the subject projects.

Section 1.2 of the offer of settlement lists section 8.4 as one of the settlement provisions that is to be "omitted entirely in new licenses."

9. Because the four Erie licenses contained the standard headwater benefits articles described above, the District, in a request for rehearing of the orders issuing the licenses, sought clarification that our approval of the settlement offer encompassed approval of the settlement offer's assessment procedures. In an order on rehearing, we rejected the District's interpretation. We pointed out that our regulations allow parties to negotiate agreements as to headwater benefits assessments but require that such agreements be filed for Commission approval. Thus, we concluded, while the parties may reach agreement on the methodology for calculating benefits, the proposed assessments must be submitted to the Commission for approval.[18]

10. Not all of the licensees of the projects downstream of Great Sacandaga Lake were signatories to the offer of settlement. Among the non-signatories was Fourth Branch, whose Mechanicville Project is located on the Hudson River downstream from the confluence of the Hudson and Sacandaga Rivers. Fourth Branch acquired complete ownership of the project from Niagara Mohawk in July 2003, after having earlier been a co-licensee with that company, and began generating electricity at the project by the end of 2003.[19]

11. In its complaint, Fourth Branch explains that, for decades, the District, pursuant to the New York law, has levied annual assessments against the Mechanicville Project and other downstream beneficiaries to cover a portion of the costs of operating, maintaining, and financing the Great Sacandaga Lake Project. Fourth Branch argues that, once the District received a license for the Great Sacandaga Project in September 2002, the

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[18] *Erie Boulevard Hydropower, L.P.*, 102 FERC ¶ 61,133 at P 14 (2003).

[19] Previous operation of the project had ceased in 1997.

District became subject to the provisions of section 10(f) for the assessment of headwater benefits and could no longer levy annual assessments for those benefits under New York law.

12. Notice of the complaint was issued on July 27, 2006. Motions to intervene in the proceeding were filed by: Erie; Niagara Mohawk doing business as National Grid; Green Island Power Authority and the Village of Green Island; City of Watervliet; BFIC LLC (Boralex) on behalf of Northern Electric Power Company, L.P., and South Glens Falls Limited Partnership; and Stillwater Hydro Partners LP. On September 25, 2006, the District filed an answer to the complaint.[20]

The Complaint

13. According to Fourth Branch, New York's Environmental Conservation Law provides that the total cost of a regulating reservoir "less than the amount which may be chargeable to the state" shall be apportioned "among the public corporations and parcels of real estate benefited, in proportion to the amount of benefit which will inure to each public corporation and parcel of real estate by reason of such reservoir."[21] Benefits are defined for statutory purposes as including:[22]

> benefits to real estate, public or private, to municipal water supply, to navigation, to agriculture and to industrial and general welfare by reason of the maintenance and operation of a regulating reservoir, whether such benefits shall inure to a person, a public corporation or the state.

[20] The notice of the complaint set August 16, 2006, as the deadline for the respondent's answer and all motions to intervene and protests. The deadline for filing an answer was later extended to September 25, 2006. The motions to intervene of Watervliet, Boralex, Stillwater, and NYSEG were filed after the original deadline. The notice of extension of time did not specifically address motions to intervene. To resolve any ambiguity as to the timeliness of these motions, we will grant them as late-filed motions.

[21] N.Y. Envtl. Conserv. L. § 15-2121.

[22] N.Y. Envtl. Conserv. L. § 15-2101(3).

Fourth Branch states that the statute also provides for the recovery by the District from the state, and from public corporations and real estate benefited, of the ongoing costs of maintaining and operating the reservoir, defined to include:[23]

> all such part of the compensation and expenses of the [regulating district] board, its officers and employees after the completion of such regulating reservoir as are in the judgment of the board and the [state] department [of environmental conservation] properly chargeable thereto.

14. The assessments of which Fourth Branch complains are based on a 1925 benefits study performed by the District's predecessor prior to the construction of Conklingville Dam. This study estimated benefits expected to be conferred on downstream sites by regulation of the dam and reservoir. As noted in section 8.4 of the offer of settlement, the District assesses costs primarily against two classes of beneficiaries based on the 1925 study: municipalities that would enjoy flood protection benefits and hydroelectric plant site owners that would benefit from regulation of the river. According to Fourth Branch, the District allocates 95 percent of these costs to the power site owners and five percent of the costs to the downstream municipalities.[24]

15. Fourth Branch asserts that, because the District is assessing it for energy gains at the Mechanicville Project from operation of the Great Sacandaga Lake Project, the assessments are clearly for headwater benefits and therefore are subject to section 10(f) of the FPA. In support of this position, Fourth Branch cites our conclusion in the rehearing order that both the District's proposed assessments for the Erie projects and any negotiated agreement determining those assessments would have to be submitted to the Commission for approval, even if the assessments were based on state law. Fourth Branch argues that section 10(f) of the FPA is part of a comprehensive federal regulatory scheme that vests the Commission with the exclusive jurisdiction to determine the level of reimbursement for costs that an upstream licensee may demand from a downstream licensee for the provision of headwater benefits. Therefore, state laws and regulations that are inconsistent with this regulatory scheme are preempted to the extent of the inconsistency.

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[23] N.Y. Envtl. Conserv. L. § 15-2101(10); 15-2125.

[24] Fourth Branch states that the District also receives operating funds through Great Sacandaga Lake permit fees and, as reflected in the offer of settlement, pursuant to a hydroelectric site agreement with Erie for the E.J. West Project.

16. Nevertheless, Fourth Branch states, the District has continued to levy assessments on the Mechanicville Project since the Great Sacandaga Project was licensed without seeking Commission approval. Most recently, on July 1, 2006, the District submitted to Fourth Branch a billing statement for the Mechanicville Project's share of the annual assessment for maintenance and operation of the Sacandaga Lake Project for the year July 1, 2006 through June 30, 2007, based on a three-year budget for July 1, 2006 through June 30, 2009. The District demanded payment by October 31, 2006, and noted that failure to pay would result in a tax lien against the property and additional service fees and penalties.

17. Fourth Branch objected to the District that the assessment did not comply with the Commission's headwater benefits regulations, but it states that this and previous objections to assessments have been met with either no response from the District or the response that the charges do not come within the jurisdiction of the Commission or the FPA. Fourth Branch asserts that the assessments levied against it by the District for the years 2003 through 2006 are unlawful, since they were made in the absence of either an agreement with Fourth Branch as licensee of the Mechanicville Project or a headwater benefits determination made by the Commission.

18. Fourth Branch claims that the pertinent New York statute conflicts with the federal scheme of regulation in authorizing reimbursement for additional costs. Fourth Branch states that, while section 10(f) limits reimbursable expenses of upstream developers to the interest, maintenance, and depreciation allocable to power, New York law provides for comprehensive reimbursement of the District's operation and maintenance expenses, including administrative expenses. Thus, the three-year District budget governing Fourth Branch's most recent assessment includes all District costs for personnel services and benefits, capital expenditures, material and supplies, and contractual expenses, with no breakdown of the District's costs associated with providing headwater benefits, as opposed to the public benefits of maintaining river quality and controlling flooding. Fourth Branch contends that its charges should be limited to that portion of the interest, maintenance, and depreciation costs of the headwater project that is allocated to power, and should include no other part of the operation costs.

19. Fourth Branch contends that the District's assessment of charges against the Mechanicville Project based on the 1925 benefit study is inequitable. Fourth Branch claims that, according to a 2003 report, the annual flood control benefits from flow regulation are more than four times greater than the annual benefits for hydropower generation, and the Mechanicville Project enjoys less than one percent of the hydropower generation benefits. Yet, Fourth Branch asserts, the District assesses the Mechanicville Project at a rate of 2.693 percent, based on the 1925 benefit study, resulting in what

Fourth Branch considers a substantial overcharge for benefits.[25] Fourth Branch complains that the District's ongoing assessments far exceed a reasonable portion of the costs.

20. Further, Fourth Branch points out that the Mechanicville Project was not authorized by the Commission to generate electricity at the time the July 2003 assessment was levied against it. It also argues that recent flow fluctuations have been unreliable and disruptive to the Mechanicville Project's production of power, undercutting the District's assumption that the Mechanicville Project is receiving substantial benefits from the operation of the Great Sacandaga Lake Project. Fourth Branch notes that District has failed to reapportion its assessments among the beneficiaries by June 30, 2000, as provided by section 8.4 of the offer of settlement. Further, Fourth Branch notes that, in the District's request for rehearing of the license order, the District stated that it intended to rely on the 1925 benefit study until the reassessment was completed.

21. Fourth Branch requests that we issue an order clarifying that, notwithstanding New York law, the District may not levy assessments against it for the provision of headwater benefits absent a Commission determination of those benefits or an agreement with Fourth Branch and Commission approval of such an agreement. Further, Fourth Branch asks us to confirm that assessments may consist only of an equitable portion, as determined by the Commission, of the District's costs for maintenance, depreciation, and interest for the Great Sacandaga Lake Project. Fourth Branch asks that we secure the District's agreement to cease issuing unilateral headwater benefits assessments against it and that, if the District fails to agree, we issue an order restraining it from issuing them.

22. Fourth Branch asks that we require the District to file, by a specific deadline, an executed agreement with Fourth Branch governing the levies issued by the District for the years 2003 through 2006, or, in the absence of such an agreement, a response showing cause why it should not be required to rescind the assessments for those years and to refund, with interest, any payments collected under them. Fourth Branch also suggests the scheduling of a settlement conference before a Commission settlement judge.

23. Fourth Branch states that the District automatically refers unpaid assessments to the county in which the realty is located, with the consequence that the unpaid amounts are subject to penalties and service charges. Because payment for the most recent assessment is due on October 31, 2006, Fourth Branch asks that we process its complaint

[25] Fourth Branch estimates this overcharge at $103,000 for the year ending on June 30, 2006.

on an expedited schedule, with instructions to the District to stay referral of any unpaid bill to the affected county for collection to preclude the imposition of these additional charges.

Intervenors

24. The intervenors are also assessed charges by the District for benefits of regulating Great Sacandaga Lake, either as licensees of other projects in the river basin or as municipalities receiving flood control benefits.[26] Collectively, they assert that disposition of the complaint may affect the charges they will be required to pay. National Grid, Green Island Power Authority and Village of Green Island, Boralex, Stillwater, and NYSEG generally support the complaint and its requested remedies but emphasize that any resolution of the assessment issue must be applied to the other downstream projects as well. Most of these licensees adopt the position of Fourth Branch that the assessments are unauthorized because they have not been approved by the Commission, and that they must be limited to an equitable portion of the District's interest, maintenance, and depreciation costs. Boralex and Stillwater, like Fourth Branch, emphasize that they were not parties to the offer of settlement.

25. National Grid, Boralex, and Stillwater join Fourth Branch in objecting to the District's failure to reapportion its assessments among the beneficiaries, as provided in the offer of settlement. National Grid requests that, in addition to granting all downstream beneficiaries the relief requested by the complaint, we also determine the effect of the complaint on the validity of recently concluded settlements between the

[26] Erie's projects, referred to earlier, are the E.J. West Project No. 2318, Stewarts Bridge Project No. 2047, Hudson River Project No. 2482, and Feeder Dam Project No. 2554. National Grid is a co-licensee of the Hudson Falls Project No. 5276 and South Glens Falls Project No. 5461. Boralex indirectly owns membership interests in Northern Electric Power Company, L.P., co-licensee of the Hudson Falls Project, and South Glens Falls Limited Partnership, co-licensee of the South Glens Falls Project. Green Island Power Authority is the licensee for the Green Island Project No. 13, Stillwater is licensee of the Stillwater Lock and Dam Project No. 4684, and NYSEG is licensee of the Upper Mechanicville Project No. 2934. All of these projects are on the Hudson River except the E.J. West and Stewarts Bridge Projects, which are on the Sacandaga River. Village of Green Island and City of Watervliet are municipalities.

District and Erie regarding past and future assessment payments, and require the District to proceed with and complete the reassessment process contained in the offer of settlement.[27]

Answer to the Complaint

26. The District states that it is a public benefit corporation created by the New York Environmental Conservation Law, which charges it to regulate the flow of the Hudson and Black Rivers "as required by the public welfare including health and safety."[28] It states that the New York law gives it a variety of powers to accomplish this purpose, including authority to build and operate reservoirs, issue bonds, and apportion costs on its beneficiaries to finance the construction, maintenance, and operation of those reservoirs. The District does not dispute Fourth Branch's general characterization of the District's history, purpose, and method of assessing benefits. However, it disagrees that section 10(f) of the FPA necessarily displaces the state assessment system and that all District assessments since the licensing of its project amount to unauthorized headwater benefits charges.

27. The District concedes that the FPA preempts inconsistent state law but argues that there is no inherent conflict between section 10(f) and the provisions of the New York Environmental Conservation Law that govern the District's funding mechanism. While section 10(f) provides for the payment of an equitable portion of a headwater project's charges for interest, maintenance, and depreciation, New York law provides for the assessment of downstream beneficiaries for an equitable share of the District's capital, interest, maintenance, and operations expenses. The District maintains that the state statute is thus consistent with Congress's objective in enacting section 10(f), because both statutes seek to guarantee that a headwater improvement owner will be compensated for an appropriate share of its costs by each downstream beneficiary. Although the District's apportionment method differs from the energy gains method specified by the

[27] National Grid adds that it became a party to the offer of settlement with the understanding that the District would reform its apportionments and assessment process to become more equitable among all of the beneficiaries. Because the District has not done so, National Grid has paid its assessments under protest and filed suit annually in the New York State Supreme Court to have its assessments reduced or negated. Those lawsuits remain pending.

[28] N.Y. Envtl. Conserv. L. § 15-2103[1], 15-2139[2].

Commission's regulations, the District points out that section 10(f) itself does not prescribe a particular methodology and that the regulations contemplate the use of different methodologies in reaching case-specific agreements.

28. Accordingly, the District argues, this is not a situation in which Congress intended to occupy the field of regulation, thereby preempting any state regulation. Therefore, we should decline to exercise preemptive authority with regard to the annual assessments and should permit the District to continue those assessments in lieu of receiving headwater benefits payments under section 10(f).

29. The District contends that preemption of the New York statutory apportionment scheme by section 10(f) would threaten the District's viability. Because the District receives no tax revenues or legislative appropriations, its facilities and operations are funded entirely by fees and statutory assessments against the entities that benefit from those operations. The District asserts that, if we require a fundamental cost reallocation between hydroelectric and non-hydroelectric beneficiaries, it will be left with a substantial funding shortfall, which it would have to recoup from entities that are not subject to our jurisdiction.

30. In describing its method of assessment, the District explains that, of the total benefits and costs allocated to parcels with head on the river, the cost is further allocated among the water power owners based on the amount of head owned by each such water power owner.[29] The District states that the latter group does not consist solely of hydropower projects but also includes industrial concerns such as mills and undeveloped parcels with power potential. The District argues that its "head-based" assessment method is rational and equitable, because parcels of land with head clearly receive the greatest benefits from the flow regulation, through additional generation. Moreover, the method is predictable, is relatively inexpensive to administer, is not subject to fluctuation, and reliably assures the District that it will recover all of its annual budget.

31. In contrast, the District contends, the energy gains method would be problematic as applied to the District's situation, because it would exclude costs associated with the District's operation and administration, which the District must recover under its organic statute, and therefore would fail to ensure the District's recovery of its entire annual revenue requirement. In addition, the energy gains method cannot be applied to non-

[29] The District confirms that, as stated by the complaint, 95 percent of the storage project's benefits are attributed to parcels of property that have head on the river and benefit from increased water power production, with the remaining five percent attributable to municipalities on the river.

hydroelectric beneficiaries and therefore would exclude downstream parcels not occupied by hydroelectric projects. Moreover, the energy gains method would require the Commission to determine what portion of the annual interest, maintenance, and depreciation costs of the Great Sacandaga Lake Project constitutes section 10(f) costs.[30]

32. The District states that it was willing to enter into the offer of settlement with the understanding that it could continue to fund its operations under the Environmental Conservation Law's statutory apportionment scheme. The District emphasizes that we approved this offer of settlement, indicating our concurrence with these precepts. It contends that it cannot function in a system in which its annual funding is dependent on two entirely separate and contradictory beneficiary apportionment and assessment schemes.

33. The District states that it was unable to complete a reassessment procedure by June 30, 2000, as provided by the offer of settlement, because the benefit study that was being prepared as a basis for reapportionment of the District's costs proved inadequate for that purpose. Therefore, it became necessary to continue to use the existing benefit apportionment for the tri-annual budget for the period July 1, 2006 through June 30, 2009.[31]

34. The District adds that Niagara Mohawk and Erie have filed state court lawsuits challenging each of the District's annual assessments since and including the 2000-2001 fiscal year. In May 2006, the District reached a settlement with Erie under which the District would provide certain credits against Erie's assessments for each of the three years covered by the present budget. The District states that the settlement does not alter

[30] Section 10(f) costs, defined in section 11.10(c)(9) of the regulations, 18 C.F.R. § 11.10(c)(9) (2006), are essentially the annual interest, maintenance, and depreciation costs that Commission staff, in determining headwater project costs, allocates to the facilities that provide power benefits to downstream projects. *See* Order No. 453, *Payments for Benefits from Headwater Improvements*, FERC Stats. and Regs., Regulations Preambles 1986-1990, ¶ 30,703 at 30,310 (1986), (51 F.R. 24308 (July 3, 1986); 51 F.R. 25362 (July 14, 1986)).

[31] The District enacts three-year budgets based on its estimates and determinations related to the cost of operating and maintaining its dams, reservoirs, and other improvements. According to the District, the benefit study referred to above, which was prepared by a consulting firm, was not submitted to the District until after the previous three-year budget had been adopted.

the District's existing budgets, assessments, or cost apportionments, while it bars Erie from contesting them for those three years. The actions brought by Niagara Mohawk remain pending.

35. The District asks us to dismiss the complaint and to find that New York's statutory apportionment and assessment scheme is not preempted by section 10(f). However, if we determine that section 10(f) requires us to establish or approve any assessments of downstream hydroelectric beneficiaries, the District asks us to waive Part 11 of our regulations to the extent necessary, to approve its existing apportionment and assessment process as a reasonable and equitable method to establish headwater benefits charges, consistent with the objectives of section 10(f), and to approve its assessments for the period July 1, 2003 through June 30, 2007. The District attaches tables showing the assessments allocated to each statutory beneficiary for each of those years.

36. The District objects to setting this matter for a settlement conference. It contends that, even if every intervenor were to participate in a settlement conference, it could not reach a resolution of this assessment issue with only those entities, because the assessments of its non-hydroelectric beneficiaries would be at risk of increasing if the District agreed to reduce the apportionment percentages of only Commission-licensed beneficiaries.[32] Moreover, it emphasizes, reapportionment under New York law is a complex and time-consuming process, so that a settlement reached with some beneficiaries could not be implemented quickly.

Discussion

37. The central question here, as Fourth Branch correctly states, is whether section 10(f) is "part of a comprehensive federal regulatory scheme that vests the Commission with exclusive jurisdiction to determine the level of reimbursement for costs that an upstream licensee may demand from a downstream licensee on account of the provision of headwater benefits to the downstream licensee."[33]

38. As an initial matter, there is no question that the District's assessments of Fourth Branch and the other downstream hydropower project owners are assessments for

[32] In addition, the District identifies downstream project licensees that have not intervened in this proceeding: Finch Pruyn & Co., licensee of the Glens Falls Project No. 2385, and Curtis Palmer Hydroelectric Co., L.P., licensee of the Palmer Falls-Curtis Station Project No. 2609.

[33] Complaint at 7.

headwater benefits. The District has been assessing Fourth Branch and the other project owners for benefits that they receive as increased energy production resulting from regulation of the reservoir; this is virtually the definition of headwater benefits. We recognized as much in the rehearing order, where we noted that the storage capacity of Great Sacandaga Lake provides significant headwater benefits and addressed the District's rehearing arguments on that basis. At the same time, it is unusual for us to encounter a headwater benefits situation in which the upstream storage project owner is an entity created by the state in which the project is located and operated under a state enabling statute, as is the case here.[34]

39. It is well-established that the FPA preempts all state and local laws concerning hydroelectric licensing apart from those adjudicating proprietary water rights.[35] Federal law may preempt state law in several ways: (1) if Congress indicates in express terms that a federal statute preempts state law; (2) by inference when Congress occupies the field by enacting legislation so comprehensive that it leaves no room for supplemental state regulation; (3) where a federal interest is so strong that the federal system is assumed to preclude enforcement of state laws on the same subject; (4) to the extent there is an actual conflict between federal and state law (where Congress has not displaced state regulation in a certain area), making compliance with both a physical impossibility; and (5) in situations in which state law poses an obstacle to the accomplishment of congressional objectives.[36]

40. The District argues that, because section 10(f) and the New York statute are trying to accomplish fundamentally the same objective, reimbursement of the upstream storage project owner for its costs, we should conclude that section 10(f) does not preempt New York law. But a coincidence in federal and state objectives does not govern a determination of preemption. In any event, we cannot accept the District's assertion that

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[34] In *Chippewa and Flambeau Improvement Company*, 31 FPC 779 (1964), five corporations that owned downstream projects had been making headwater benefits payments according to the laws of Wisconsin, including the enabling act of the company that owned the upstream storage reservoirs, but the company was a private one owned by the five corporations.

[35] *See California v. FERC*, 495 U.S. 490 (1990) and *Sayles Hydro Association v. State Water Resources Control Board*, 985 F.2d 451 (9th Cir. 1993).

[36] *See Wisconsin Valley Improvement Company v. Wisconsin Department of Natural Resources*, 910 F. Supp. 1375 (W.D. Wisc. 1995), summarizing United States Supreme Court precedent.

there is no inherent conflict between the federal and state statutes. Section 10(f) requires that downstream hydro beneficiaries pay for an equitable portion of interest, depreciation, and maintenance, and that the Commission require reimbursement "for such part" of these items as "the Commission may deem equitable." It also provides that "[t]he proportion of such charges to be paid by any licensee shall be determined by the Commission." Section 10(f) does not provide for final determinations of these matters to be made by the state in which the storage project is located. To the extent that adherence to the New York statutory scheme would bypass the Commission's prerogative to determine and approve the appropriate level of headwater benefits charges, the New York statute certainly must yield to section 10(f). The District itself implicitly acknowledges this conflict in claiming that it "cannot function in a system in which its annual funding is dependent on two entirely separate and contradictory beneficiary apportionment and assessment schemes, one federal and one State."[37]

41. The District argues that we approved the offer of settlement, which expressly contemplated that it would continue to assess its statutory beneficiaries under New York law and that any reapportionment procedures would be conducted outside the jurisdiction of any of the licenses. However, approval of the offer of settlement did not, and cannot, make the requirements of section 10(f) a nullity. We have already made it clear, in the rehearing order, that the District must comply with section 10(f) in respect to obtaining Commission approval of proposed assessments or of any agreement negotiated to determine them, even though the District and downstream project owners would be free to agree on the methodology for calculating benefits.

42. In any event, approval of a settlement offer does not automatically incorporate all settlement terms as license conditions. Here, in fact, the settlement offer itself specifically provided that section 8.4 would be omitted from the licenses. Thus, this provision is a private matter between the District and the other signatories in respect to the application of New York law; it does not constrain our prerogative, or limit our statutory responsibility, to apply the section 10(f) requirements for Commission review and approval of headwater benefits assessments, even as to those hydropower beneficiaries that signed the settlement offer. Moreover, few of the downstream hydropower project owners were signatories to the offer of settlement. Fourth Branch and the other non-signatories cannot be said to have acceded to the primacy of state headwater benefits assessment procedures as a substitute for the requirements of section 10(f).

[37] Answer at 24.

43. As the District notes, section 10(f) does not specify the procedures for Commission determination of equitable charges to be paid by downstream beneficiaries. These procedures are established in Part 11 of the Commission's regulations, which essentially provide for either a Commission investigation to determine these charges or a negotiated settlement to be approved by the Commission. The District asks us to waive Part 11 if we determine that section 10(f) preempts state authority over the determination or approval of headwater benefits charges, and to approve its apportionment and assessment process, as well as the assessments themselves. However, Fourth Branch's complaint is directed not only to the District's failure to submit to the Commission's headwater benefits authority but also to the fairness of the charges being assessed. We think it would be inappropriate to waive our regulations and simply accept the District's assessments, since to do so would deprive Fourth Branch and other downstream project owners of the Commission's own analysis of whether the charges are equitable or of an opportunity to negotiate with the District to determine charges on which all affected parties could agree. Indeed, the District, by committing itself to a benefits reassessment under New York law, has conceded that the present charge allocation may not be equitable.

44. Of particular concern is Fourth Branch's argument that the District is assessing it for charges other than interest, maintenance, and depreciation. The District does not deny that it has been assessing beneficiaries for these charges, particularly for administrative and operating expenses, reimbursement for which is permitted under the New York law. To the extent that the District is assessing for interest, maintenance, and depreciation charges, section 10(f) clearly requires a Commission determination of the extent to which the charges are equitable and the proportion of the charges to be paid by any licensee.[38] To the extent that the District is authorized under New York law to assess for additional charges, we must address whether section 10(f) was intended to preclude collection for any charges other than interest, maintenance, and depreciation.

45. As stated in the first Commission order rendering an assessment for headwater benefits, *Southern California Edison Company*,[39] section 10(f) contemplates that

[38] Although the District's answer indicates that the New York statute authorizes reimbursement for interest and maintenance expenses, it does not mention depreciation, so that it is not clear to us whether the District is charging Fourth Branch and the other downstream beneficiaries for this expense.

[39] 1 FPC 567 at 574 (1939).

downstream project owners "shall participate in the financial burden incident to the orderly and systematic construction of power and storage facilities of a river basin." Further, section 10(f) gives the Commission

> the task of equitably apportioning the annual charges for interest, maintenance and depreciation of the upper headwater improvements so that each beneficiary may contribute its just share for the construction of such upper improvements of common benefit.

Thus, in requiring reimbursement from downstream project owners, Congress focused on costs of constructing the upstream project. However, the legislative history of section 10(f) is sparse and does not otherwise reveal Congress's reasons for limiting reimbursable costs to interest, maintenance, and depreciation.

46. In our final rule setting forth procedures for determining and assessing headwater benefits payments, we stated that "[d]ownstream power beneficiaries pay only that portion of the interest, maintenance, and depreciation costs of the headwater project that are allocated to power, and no part of the operation costs."[40] In their pleadings, both Fourth Branch and the District recognize that, in requiring reimbursement for maintenance charges under section 10(f), we do not include general administrative and operations expenses. However, the legislative history of section 10(f) does not indicate Congressional intent regarding the assessment of downstream hydropower owners for operational costs, or for other expenses besides interest, depreciation, and maintenance, pursuant to state or local authority.[41]

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[40] Order No. 453, *Payments for Benefits from Headwater Improvements*, FERC Stats. and Regs., Regulations Preambles 1986-1990, ¶ 30,703 at 30,310 (1986), (51 F.R. 24308 (July 3, 1986); 51 F.R. 25362 (July 14, 1986)).

[41] In introducing a floor amendment that constituted Congress's first effort to include a headwater benefits payment section in the legislation that became the Federal Water Power of 1920, predecessor to the FPA, Representative Esch of Wisconsin explained that licensees were to "annually pay into an amortization reserve fund a proportion of the cost of operation and maintenance and of interest charges represented by the construction of the reservoir by the first licensee." 56 Cong. Rec. 9915, as cited in *Louisville Gas and Electric Company*, 58 FERC ¶ 61,338 at n.18 (1992). Nevertheless, for whatever reason, costs of operation were not specified in section 10(f), and the Commission has not required reimbursement of these costs by downstream project owners.

47. It could be argued that Congress intended for section 10(f) to preempt any state or local assessment and payment scheme. In enacting section 10(f), Congress primarily intended to ensure that upstream project developers would be reimbursed by downstream owners of hydropower projects that receive benefits from upstream storage regulation. At the same time, because section 10(f) limits the extent of that reimbursement to charges in the categories listed in section 10(f) and, at that, to an "equitable" part of those charges, Congress may also have intended to free downstream project owners from the further financial burden of assessments for additional items by upstream storage project owners pursuant to state law. Under this view, Congress would have intended the charges authorized under section 10(f) to constitute the entire extent of equitable reimbursement for upstream project expenses.

48. Nevertheless, the statute and legislative history do not explicitly reveal a Congressional intent to prohibit additional charges pursuant to state law, and we are reluctant to infer one. Since Congress meant to ensure reimbursement for the costs of upstream project construction, its omission of operational and other costs from the items specified in section 10(f) suggests that it did not consider those costs sufficiently related to upstream project construction to necessitate their inclusion. Given that Congress did not explicitly authorize the Commission to require reimbursement of these costs from downstream project owners, we would be hesitant to conclude that Congress meant to foreclose states from doing so.

49. The relationship between section 10(f) and the New York statute must be evaluated in respect to the preemption considerations listed earlier. Congress has not expressly indicated that section 10(f) should preempt state law as to all upstream storage facility charges. We do not think that section 10(f) is such a comprehensive statutory provision that there is no room for supplemental state regulation of charges that are not specified in that section. There is no physical impossibility involved in compliance with section 10(f) as to interest, maintenance, and depreciation assessments and with state law as to assessments for other expenses. The federal interest underlying section 10(f) is ensuring the participation of downstream project owners in the financial burden incident to the construction of power and storage facilities of a river basin. This interest is not undermined by allowing states to assess for the operating expenses of state-controlled storage projects, and in that respect the New York law does not pose an obstacle to the accomplishment of that Congressional objective.

50. We think that Congressional concerns and the provisions of section 10(f) are satisfied by the Commission's requirement for reimbursement of an equitable portion of interest, maintenance, and depreciation. If this Congressional purpose is satisfied, reimbursement for other charges is not meant to be a matter for Commission involvement but may be addressed by the states. That a contrary result would be problematic and disruptive is illustrated by the situation before us here. As a creation of the state of New

York, with the responsibility for operating Great Sacandaga Lake and other storage facilities, the District has expenses that do not fall within the categories specified by section 10(f). Conklingville Dam and Great Sacandaga Lake serve purposes other than regulation of flows to enhance hydroelectric generation. Although the District brought itself to some extent within the Commission's jurisdiction when it received a license, it did not remove itself from New York's jurisdiction as to matters that are not covered by the FPA. We do not think that Congress intended section 10(f) to preclude a state-created entity from recovering all of the costs of operating and administering a storage project that affects a variety of downstream uses within that state.

51. Accordingly, assessments for interest, maintenance, and depreciation in respect to the Great Sacandaga Lake Project cannot be implemented solely pursuant to New York law but rather are subject to approval by the Commission. Moreover, any headwater benefits determination made or approved by the Commission could not be confined to assessments for Fourth Branch but would have to encompass all of the hydropower projects that receive headwater benefits from the Great Sacandaga Lake Project. However, it would not include other entities that receive actual or potential energy benefits, such as mills and undeveloped parcels, or flood control benefits, such as municipalities, since we have no jurisdiction over charges assessed to entities other than hydropower project owners. The District is free to determine payments owing from these non-hydropower entities for any of its expenses, as well as payments from any beneficiaries, hydropower or otherwise, for operating expenses and any other items which are authorized under New York law and for which the Commission has no authority under section 10(f) to require licensees to reimburse upstream owners.

52. Section 11.12(a) of the Commission's regulations[42] provides that, for non-federal headwater projects, if a party requests the Commission to determine charges, the Commission will determine on a case-by-case basis what portion of the annual interest, maintenance, and depreciation costs of the headwater project constitutes the section 10(f) costs. Although the complaint asks us to determine the validity of the District's assessments conducted under New York law, neither Fourth Branch nor any other affected project owner has requested us to determine headwater benefits charges for this river basin. If such a request were made, we would apply the energy gains method to determine charges unless the affected parties reached, and we approved, a settlement with respect to those charges.[43]

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[42] 18 CFR § 11.12(a) (2006).

[43] 18 CFR § 11.11(a)(2) (2006).

53. Because a Commission investigation requires submission of project-specific data by both upstream storage project owners and downstream hydropower beneficiaries, as set out in the regulations,[44] it is generally beneficial for all project owners if a settlement can be reached. This is particularly true in the case of non-federal headwater projects, for which the regulations do not require that settlements result in headwater benefits payments approximating those that would result under the energy gains method, unlike settlements for federal headwater projects.[45] Moreover, the regulations provide that, when the Commission is asked to determine headwater benefits charges for benefits provided by non-federal headwater projects, the headwater project owner (if there is only one) must pay 50 percent of the cost of making the investigation and determination, and the downstream project owners must each pay a pro rata share of 50 percent of the cost, in proportion to the energy gains received by their projects.[46] Because the costs of conducting a headwater benefits determination in a complex river basin such as this one can be substantial,[47] reaching a settlement would be highly advantageous to both the District and the downstream hydropower beneficiaries.[48]

54. As Fourth Branch requests, we clarify here that headwater benefits assessments relating to charges for interest, maintenance, and depreciation are within the authority of this Commission under section 10(f) of the FPA, which preempts New York law to the extent that it would authorize the collection of charges for these expenses without Commission approval. However, we find that the District is not precluded by

[44] 18 CFR § 11.16 (2006).

[45] 18 CFR § 11.14(a) (2006).

[46] 18 CFR § 11.17(c)(2) (2006).

[47] Past studies of similar river basins have cost in the range of $250,000 to $300,000.

[48] As noted earlier, in May 2006, the District reached a settlement with Erie under which the District would provide credits against Erie's assessments for each of the three years covered by the present budget. This settlement was not submitted to or approved by the Commission, and it does not affect our responsibility under section 10(f) to determine the proportion of the equitable charges for interest, maintenance, and depreciation that each downstream hydropower project owner receiving headwater benefits should pay the District.

section 10(f) from assessing charges for other expenses as authorized by New York law. Beyond this clarification, we are constrained from taking a number of actions that Fourth Branch urges.

55. Fourth Branch asks us to clarify that the District may not levy these headwater benefits assessments in the absence of a Commission determination, to secure the District's agreement to cease issuing them, and to issue an order restraining it from doing so if it fails to agree. While section 10(f) governs assessments for interest, maintenance, and depreciation expenses, we do not undertake a headwater benefits determination for benefits from a non-federal storage project in the absence of a request to do so. If we make or approve a headwater benefits determination, we can require downstream beneficiaries to make payments in the amounts determined, but we have no authority to prevent a storage project from attempting to assess charges from downstream projects under color of state law and in the absence of a Commission headwater benefits determination. Similarly, we have no authority to require the District to rescind assessments made under state law, to refund the amounts paid, or to stay referral of unpaid bills to the affected counties for collection. Fourth Branch's remedy for these assessments lies in the court system.

56. We also have no authority to require the District to initiate the reapportionment procedure provided for by section 8.4 of the offer of settlement. As we have already noted, that section of the settlement was not incorporated into the license and remains a private agreement. Moreover, regardless of the primacy of section 10(f) in respect to assessments for interest, maintenance, and depreciation, the reapportionment procedure relates solely to the District's responsibilities under state law. While we can envision that a reapportionment of expenses among downstream beneficiaries might form a productive basis for a settlement that could be submitted to the Commission for approval as a means of determining headwater benefits under section 10(f), the reassessment procedure itself is not our concern.

57. We will not set this matter for a proceeding before a settlement judge. Any further Commission involvement in this matter must be preceded by a request from an affected project owner that we conduct a headwater benefits determination. At that time, we

could address whether it would be useful to refer this matter to a settlement judge, as well as whether time should be provided for the District and the downstream project owners to negotiate a settlement determining the appropriate assessments.[49]

The Commission orders:

The complaint filed July 25, 2006, by Fourth Branch Associates (Mechanicsville) against Hudson River - Black River Regulating District is granted to the extent indicated in this order and denied in all other respects.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

[49] In previous proceedings, we have referred disputes over headwater benefits assessments to a settlement judge, but only when it has otherwise not been possible to resolve beneficiaries' disagreements with the results of a headwater benefits study report that has been issued by the staff. *See, e.g., Public Service Company of Oklahoma*, 25 FERC ¶ 61,133 (1983).