

D.C. Circuit Vacates FERC's Federal Land Fees Schedule

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On January 4, 2011, the U.S. Court of Appeals for the District of Columbia Circuit vacated the Federal Energy Regulatory Commission's (FERC) 2009 final rule establishing annual charges for hydropower projects operating on federal lands. This case, *City of Idaho Falls, Idaho, et al. v. FERC*, was resolved in favor of a large coalition of hydropower licensees represented by Van Ness Feldman, P.C. The court's ruling is significant because coalition members may save or be refunded millions of dollars in annual charges payments, and all hydropower licensees could save millions more in annual charges bills for 2010, and possibly beyond. The ruling also confirms that changes to agency regulations must adhere to notice-and-comment procedures under Section 553 of the Administrative Procedure Act (APA).


BACKGROUND

Section 10(e)(1) of the Federal Power Act (FPA) requires FERC to establish "reasonable" annual charges for hydropower licensees' use and occupancy of federal lands. To carry out this directive, FERC completed a notice-and-comment rulemaking in 1987, where it reviewed and analyzed several proposed methodologies for setting these annual charges, and ultimately adopted a methodology that utilized valuations developed by the U.S. Forest Service (USFS) for assessing fees for linear rights-of-way on USFS-managed federal lands. Because the USFS methodology included an annual inflationary adjustment to the fees schedule, FERC's 1987 rulemaking required FERC to "update its fees schedule to reflect changes in land values" established by USFS.

From 1987 through 2008, FERC annually updated its fees schedule as provided in its regulations. At the end of 2008, however, USFS implemented an entirely new methodology for calculating its fees schedule for linear rights-of-way on federal lands. For most areas of the United States, this new methodology uses substantially higher land value estimates and, consequently, a much higher fees schedule.

In February 2009, FERC issued a final rule—without prior notice or opportunity for comment—adopting USFS's new fees schedule (calculated according to the new USFS methodology), and then issued bills to hydropower licensees according to the new 2009 fees schedule. For some hydropower licensees, the new fees schedule resulted in substantially higher annual charges, with some increases approaching 700 percent more than the 2008 annual charges.

A coalition of hydropower licensees obtained an emergency stay of FERC's 2009 fees from the D.C. Circuit and filed for rehearing with FERC arguing, *inter alia*, that FERC's final rule promulgating the 2009 fees schedule violated the notice-and-comment requirements of Section 553 of the APA, as well as FERC's obligation under FPA Section 10(e)(1) to assess fees that are "reasonable." In October 2009, FERC denied the coalition's



rehearing request. FERC held, *inter alia*, that its issuance of the 2009 fees schedule did not trigger a notice-and-comment obligation under APA Section 553. Interpreting its 1987 regulations, FERC held that it has a non-discretionary obligation to update its fees schedule based on USFS’s annual updated fees schedule, regardless of the methodology used by USFS to develop that fees schedule. FERC found, moreover, that its 1987 rulemaking already satisfied its FPA Section 10(e)(1) obligation to ensure annual charges are “reasonable.” Commissioner Philip Moeller dissented, stating his preference to obtain public comment prior to implementing a new methodology for assessing fees.

D.C. CIRCUIT DECISION

The D.C. Circuit granted the coalition’s petition for review and vacated FERC’s 2009 fees schedule. Finding that “FERC’s interpretation of [its regulation] improperly divorces the regulation’s text from both the rulemaking process from which it emerged and the underlying statutory scheme pursuant to which it was issued,” the court held that FERC’s issuance of the 2009 fees schedule violated both APA Section 553 and FPA Section 10(e)(1). In particular, the court found “it entirely implausible that FERC adopted the Forest Service linear rights-of-way index without regard to the methodology the Service uses to generate it.” The court found FERC’s interpretation “especially dubious” because it would require FERC to “accept, without notice and comment, any new methodology adopted by the Forest Service—including even one that the Commission had itself rejected.”

The court also held that FERC’s regulatory interpretation violated the express requirement under FPA Section 10(e)(1) to establish reasonable annual charges. “FERC’s power to set charges is exclusive and . . . its duty to ensure that rates are reasonable is both mandatory and non-delegable.” Because FERC alone must evaluate the reasonableness of these annual charges, it cannot simply pass through USFS’s annual updates if they are based on a new methodology “without engaging in its own independent review to ensure that, in its judgment, the resulting rates are reasonable.”

IMPLICATIONS

The D.C. Circuit’s ruling will have far-reaching implications to FERC’s annual charges program. For coalition members involved in the litigation, the ruling is likely to result in millions of dollars in cost savings or refunds in annual charges payments for 2009. Depending on how FERC responds to the ruling, similar savings are possible for 2010 for all licensees, as FERC withheld its 2010 bills pending the outcome of the case. For 2011 and beyond, FERC is likely to initiate a rulemaking process, which will provide an opportunity for comment by hydropower licensees and others. As part of this process, licensees will be afforded an opportunity to evaluate impacts associated with any new methodology FERC proposes to adopt, and to submit comments to FERC explaining how the proposal would impact the regulated community and ratepayers.

More broadly, the court’s opinion confirms that although judicial review of an agency’s interpretation of its own regulations is deferential, such review is meaningful and substantive. Where, as here, an agency ignores the historical context of a regulation, overlooks a statutory mandate or the plain language of a regulation, or



interprets a regulation illogically, the D.C. Circuit will not hesitate to disregard the agency's interpretation, to ensure that any regulatory changes are implemented only through a public notice-and-comment rulemaking.

FOR ADDITIONAL INFORMATION

Van Ness Feldman's hydroelectric practice provides comprehensive legal, policy, and business advisory services for the full range of issues facing the hydropower industry. The firm's litigation practice, recognized as a leading energy litigation practice by *Legal 500*, handles a wide range of energy, environmental, and natural resource matters, with a focus on appellate proceedings such as this. If you would like additional information on the D.C. Circuit's opinion, please contact Chuck Sensiba in our Washington, D.C. office, at 202-298-1800, or any other attorney in Van Ness Feldman's Hydropower or Litigation practices in Seattle, WA or Washington, D.C.

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