

April 21, 2013

Attn: Mayor Elect Moore
From: Neil Anderson

INFORMATION MEMORANDUM

RE: PROPOSED HYDROPOWER DEVELOPMENT ON LOCK & DAM #24 AND LOCK & DAM #25 ON THE MISSISSIPPI RIVER HELD UNDER FERC PRELIMINARY PERMITS ISSUED TO THE CITY OF QUINCY, ILLINOIS

Further to our ongoing discussions regarding potential hydro development on these sites the following is an Information Memo provided by our legal counsel Nixon Peabody of Washington, DC as a description of the scope of participation by non-municipal entities in hydroelectric projects when the developer is a municipal entity and, as a preliminary permit applicant claims the municipal preference. This Memo will outline the rules as implemented by the Federal Energy Regulatory Commission (“FERC”) both through its regulations and via FERC orders issued over the years. Interesting highlights are outlined in yellow.

Background

Part I of the Federal Power Act¹ (“FPA”) provides the scheme for licensing hydroelectric projects in the United States. The FPA allows an entity seeking to study the feasibility of project development at a site to obtain a preliminary permit. The preliminary permit may have a term of up to 36 months and provides the permitted (and a license applicant) with a preference when filing a license application over those who file in competition with them. Section 7(a) of the FPA provides a preference in the preliminary permit process to State and municipals.² **So, if there are two preliminary permit applications filed on the same day for the same project, and one applicant is a municipal, the municipality³ will obtain the permit.**

¹ 16 U.S.C. § 796 *et seq.*

² FPA Section 7(a), 16 U.S.C. § 800(a).

³ A municipality is defined in FPA Section 3(7) as: “a city, county, irrigation district, drainage district, or other political subdivision or agency of a State competent under the laws thereof to carry on the business of developing, transmitting, utilizing, or distributing power.”

(Footnote continued on next page)

Over the years the FERC has addresses two main types of what it considers to be a violation of the municipal preference: (1) abuse via transfer; and (2) impermissible “hidden hybrids.” The original form of violation of the municipal preference arose in the 1980s when a municipal obtained the preliminary permit and, right before its expiration, the permittee would withdraw the permit and a joint venture of the municipal and a private entity or a private entity would file a license application.⁴ In fact, FERC created “a rebuttable presumption that municipal preference has been abused where a municipality obtains and surrenders a permit, and within 90 days of the effective date of surrender, a non-municipality, in apparent coordination with the municipality, submits a license application for the same site.”

Most of the FERC’s orders in the last 10 years have involved the “hidden hybrid” situation – where the municipality obtains the preliminary permit but the municipality shares ownership and/or control of the project with a third party, non-municipal developer.⁵

It is important to note that the Commission will not generally look at issues involving a “hidden hybrid” until the licensing phase. In at least one case, a municipality filed a petition for declaratory order with FERC to get FERC’s approval of the arrangement between a non-municipal developer and a municipality.

Permitted Arrangements

Based on FERC precedent there are some boundaries on what we know FERC finds as an acceptable arrangement between a municipality and non-municipality in the permit and licensing of hydroelectric projects.

In *Idaho Water Resources Board*, 84 FERC ¶ 61,146 (1998), the FERC stated, “[m]unicipal preference is not jeopardized by contractual arrangements between municipal and non-municipal entities for financing, studying, constructing, or operating a licensed project, so long as the municipality retains the rights in and control over the operation and maintenance of the project necessary for project purposes.” However, any financing arrangement or other agreement where the non-municipality would hold property rights would constitute a hidden hybrid. The developer can act as agent for the license applicant.

(Footnote continued from previous page)

⁴ See *City of Fayetteville Public Works Committee*, 16 FERC ¶ 61,209 (1981).

⁵ *Gregory Wilcox*, 24 FERC ¶ 61,317 (1983), *reconsideration denied*, 26 FERC P 61,113 (1984), *reh'g denied*, 27 FERC P 61,403 (1984), *vacated on other grounds sub nom., Uncompaghre Valley Water Users Ass'n v. FERC*, 785 F.2d 269 (10th Cir. 1986), *cert. denied*, 479 U.S. 829, 107 S. Ct. 112, 93 L. Ed. 2d 60 (1986). See also, *Malta Irrigation Dist. v. FERC*, 955 F.2d 59, 293 (D.C. Cir. 1992) .

In *Town of Summersville, West Virginia*, 60 FERC ¶ 61,291 (1992), after reviewing a development agreement between the Town of Summersville, West Virginia and Noah Corporation, the FERC required modification of the agreement, but found the agreement not to be a hidden hybrid:

[u]nder the agreement, Noah is to manage all aspects of the licensing, financing, design, construction, operation, and maintenance of the project, subject to the direction and control of Summersville, which will own all project property exclusively. Summersville has the right to direct and control Noah “in each and every action undertaken pursuant to the agency” established by the agreement, and Noah must consult with Summersville before taking actions “significantly” affecting the project, “unless exigent circumstances require otherwise.” Under these provisions, Summersville appears to retain the requisite control over project operations required by the FPA. 60 FERC at 61,985-6.

Under this agreement, Summersville would pay Noah a monthly fee equal to 49% of the proceeds of the project and if project expenses exceed gross income, Noah will receive no fee. Project proceeds are defined as “gross income (consisting of power sales revenues to a utility plus an amount equal to the fully allocated cost of any project power used by Summersville) less monthly expenses incurred by Noah. According to FERC, “it is the possession of proprietary interests in project property that distinguishes a licensee from parties that are mere beneficiaries of a project.” *Id.* at 61,986.

In *City of Augusta, et. Al*, 72 FERC ¶ 61,114 (1995), the FERC approved another arrangement between a municipality and a non-municipal. Here, the City of Augusta was the licensee and claimed the municipal preference. Other competitors (including other municipalities) argued that its arrangement with SEI/Daniel was a hidden hybrid. The City of Augusta submitted the contract to the FERC and the FERC found that the arrangement acceptable. Under this arrangement, SEI/Daniel would have the “title and rights to the design, plans, maps, and specifications” for the license application. SEI/Daniel would assume the costs of pursuing the license application. SEI/Daniel would receive a share of the project revenues if the project obtained a license. It appears that the “ownership” of license materials (not land) arose prior to the filing of the license application. In fact, if SEI/Daniel entered into an EPC contract for the construction of the project, title to the license materials would be jointly owned. If the City entered into an EPC contract with another entity, title to the materials would transfer to the City of Augusta only after the City’s payment of a development fee. SEI/Daniel’s work would be “at the direction of” and “on behalf of” Augusta, which would own the project and “responsible for meeting the financing obligations and start-up, operation and maintenance expenses.” 72 FERC at 61,595. A copy of the development agreement is attached to this memo.

In *Owyhee Irrigation District, et al.*, 55 FERC ¶ 61,252 (1991), FERC granted a petition for declaratory order filed by the irrigation district that sought FERC approval of an arrangement between a

municipal and non-municipal license applicant. Under this agreement, in return for Owyhee Ditch Company's participation in the project, including financial contributions to construction of the project, the Ditch Company would receive a share of the net revenues from the project. The Ditch Company's share was equal to the percent of irrigated land held by the Ditch Company, which worked out to 11.08% of the project revenues. In approving this contract, FERC reinforced that sharing of revenues should not convey to the nonlicensee "rights necessary to fulfill project purposes. . . ." *Id.* at 61,084. In this case, net revenues would exclude project costs (including debt service) and other municipal licensee's shares of project revenues.⁶ The rights to a share of project revenues would not convey interests in project property or rights necessary to accomplish project purposes. FERC required the parties to include in the contract a provision that explicitly states that the contract "shall not encumber the licensees' compliance with the license and with any future Commission orders."

In *Village of Saranac, New York*, 62 FERC ¶ 61,164 (1993), the FERC approved a financing arrangement where a non-municipal entity, Lake Flower (comprised of board members of the Village of Saranac) received by conveyance Saranac's rights to receive payments under its PPA with a utility. Payments to Lake Flower would be "limited to an amount, including interest and costs, that is equal to any loan received by Lake Flower from any bank . . . or other lender, the proceeds of which are used to construct and improve Project No. 8369, plus recovery of reasonable financing costs associated with the loan." *Id.* at 62,126. The lease consisted of "personal property and equipment." *Id.* Lake Flower would pay to Saranac monthly rent equal to 1/12 of the moneys Lake Flower receives during the year under the PPA assignment. The lease "requires Lake Flower to maintain the leased equipment in good repair, to bear the risk of loss of the equipment, and to maintain appropriate property damage and liability insurance on the equipment, with losses payable to Saranac" and to any bank. Saranac retained all rights in project property necessary to fulfill project purposes under the financing arrangement. In approving the arrangement, FERC noted, consistent with prior precedent, that the licensee must hold all property and other rights necessary for construction, maintenance and operation of the projects. FERC found that the primary purpose of the arrangement was to obtain project financing. None of the rights transferred included rights needed for project purposes. Saranac would retain title to the property and

⁶ According to the order, "net revenues" "refers to money remaining from gross income after all costs reasonably attributed to the operation of the entire [Project No. 4354] have been deducted. Such costs shall be reasonable and necessary costs calculated under generally accepted accounting principles and shall include, but are not limited to, the actual cost of producing electricity, debt service payments, licenses, fees, interest, expense of meeting FERC, and U.S. Bureau of Reclamation, other governmental regulation, expenses paid or disbursements made to comply with the Power Sales Agreement between [Owyhee] and Idaho Power Company, transmission line costs, accounting and legal services, engineers and consultants fees, and all direct and indirect expenses." 55 FERC at 61,804.

would operate the project. FERC required inclusion of a provision requiring that no document will encumber Saranac's compliance with any FERC requirement or FERC order.

Memo Conclusion

In sum, there are a number of arrangements that the FERC has found permissible with its municipal preference rules and precedent. The most important feature of a proper municipal arrangement with a non-municipal developer is that the title to and control of all project properties and operational control remain with the municipality. The developer, however, can receive a share of project revenues in return for the services provided and those arrangements will pass FERC scrutiny.

The most effective way to determine whether a particular arrangement complies with FERC policy and precedent is to file a petition for declaratory order seeking FERC affirmance of the arrangement. Short of that, arrangements that meet the scope of these others should satisfy FERC's standards.

Provided by Neil Anderson

April 21, 2013