

**COMMENTS
OF THE
NATIONAL HYDROPOWER ASSOCIATION
ON THE
GAO REPORT TO CONGRESS ON FEDERAL LAND USE FEES
FOR
HYDROPOWER PROJECTS**

MARCH 31, 2003

INTRODUCTION

The National Hydropower Association (NHA) submits the following comments to the United States General Accounting Office (GAO) on its draft report to Congress entitled, "Charges for Hydropower Projects' Use of Federal Lands Need to be Reassessed (GAO-03-383)." NHA appreciates the opportunity to comment on the draft report for inclusion in the final report that is forwarded to Congress by GAO.¹

MAJOR CONCERNS AND CONCLUSIONS

- GAO's methodology, if adopted, could easily increase retail rates to consumers, particularly in the West, by hundreds of millions of dollars per year. These are consumers who are still reeling from the energy crisis that affected the entire western region of the United States in 2001.
- GAO's methodology could produce highly volatile land use charges and could generate significant uncertainty in its application. Should the Federal Energy Regulatory Commission (FERC) follow GAO's example and implement this methodology, FERC would require new staff resources and lengthy dispute resolution procedures. The new system would also impose a significant administrative burden on the industry to develop the paperwork necessary for FERC to set the new fees.
- GAO's methodology is technically flawed. It produces negative "net benefits", yet does not propose that FERC pay licensees under such circumstances. It could produce annual land use charges that could vary by many orders of magnitude from one year to the next. It relies on market price indices recently judged to have been manipulated by market participants. It assumes that all economic rents should be allocated only for land, and not for other fixed inputs such as the investments made by project licensees on behalf of their consumers. Finally, it does not take into account the public benefits already provided by licensees under license conditions, including parks, recreational opportunities, and fisheries enhancement. In essence, GAO's methodology would permit the federal government to collect twice; once through license conditions and another time through land use charges. This methodology simply does not represent "fair market value."
- The GAO methodology is inconsistent with federal policies on hydropower. Its adoption would be a step in the wrong direction, particularly in light of all the work underway in Congress to resolve problems facing the hydropower resource and provide incentives for new development. Considering the nation's need for more renewable energy, now is not the time to

¹ NHA appreciated GAO's willingness to meet with individual members of the hydro industry and with the Association. However, for purposes of providing comments, NHA was not allowed to retain a copy of the draft report. As a result, these comments are based solely on notes and memory from two viewings of the draft report.

pursue policies that would undermine hydropower's role as the nation's leading renewable energy source.

BACKGROUND

Non-federal hydropower owners and operators whose projects are fully or partially located on federal land pay rent for the use of the public land. These land use charges are administered by the Federal Energy Regulatory Commission (FERC). The Federal Power Act (FPA) gives FERC the authority to collect these charges. FERC was not directed to obtain “fair market value” for the land. Instead, FERC was authorized to establish “reasonable” fees that balance land use with the public benefits of low cost and abundant supplies of energy.

In the 1990’s, a FERC rulemaking explored several options to set charges for using public lands. After due deliberation, FERC adopted the U.S. Forest Service’s fee system for linear rights of way on National Forest System land. The Forest Service zonal fee system annually produces a per acre charge on a county-by-county basis for every state. The zonal fees were prepared for homogeneous regions based on ROW appraisal information furnished by the utility industry. FERC charges the same fee as the Forest Service for transmission lines, and twice that amount for other federal land used within a hydropower project boundary.

In late 2000, the GAO agreed to a request by the Interior and Energy and Water Development Subcommittees of the House Appropriations Committee to prepare a report on federal land use charges for hydropower projects licensed by FERC. GAO shared a draft report with NHA for comment on March 17th and 19th of 2003. In its report, GAO asserts that the current charges applied to FERC-licensed hydropower projects do not represent a “fair market value” for the use of such public lands.

GAO’s draft report suggests that FERC reassess its system of annual charges in light of: 1) information it provides concerning the estimated value of the contribution federal lands make to hydropower production; 2) the trend toward the restructuring of the nation’s electric markets; and 3) flaws in the present system. The GAO also recommends that FERC develop new strategies for assessing annual charges commensurate with the benefits licensees receive. In conducting this reassessment, GAO suggests FERC determine methods for estimating “fair market value” of federal lands, and determine methods for assessing annual charges, taking into account the fair market value of the federal lands, while also achieving the competing goals of encouraging hydro development and avoiding unreasonable increases in electric rates to consumers.

NHA strongly believes the draft report is flawed and that the GAO’s methodology is not applicable to determining the value of federal lands to a FERC-licensed hydropower project. Fair market value, as determined by a “net benefits” calculation, is not an appropriate means of determining land use charges for federal lands. Though GAO does not recommend that FERC adopt its approach, should the Commission use this method, it could spell disaster for a sizable segment of the hydropower industry and its electric consumers. Should FERC decide to re-evaluate its system of determining annual charges based on this report, NHA recommends that the Commission reject the fair market value/net benefits approach. NHA also believes Congress should reject the fair market value analysis underpinning this report.

Based on information disseminated by GAO in meetings with the hydropower licensees whose 24 hydro projects were studied, implementation of the “net benefits” methodology would cause huge increases and huge changes in annual federal land use charges from year to year. For instance, compared with current charges, the percentage change, using the GAO “net benefits” methodology, could range from approximately negative 130,000% to positive 875,000% depending on the project, market conditions and

the share of annual net project benefits paid as land use fees. In fact, based on 2000 market values and project characteristics, the land use charges for one particular project in the Northwest would skyrocket from \$371,000 to over \$602 million a year! This is especially troubling when one considers that Congress is currently exploring legislative solutions to prevent unreasonable increases in granted, issued or renewed rights-of-way fees associated with deployment of telecommunications and other critical infrastructure on federal lands.

The increased costs resulting from implementation of this GAO methodology would directly impact ratepayers. In addition, implementing this methodology would create a new layer of bureaucracy at FERC and further complicate the hydropower regulatory process. At a time when FERC is administering the most extensive and complex regulatory process for any energy source in the United States, it cannot afford to mobilize the huge effort necessary to implement GAO's complicated scheme. More importantly, implementing the GAO methodology could undermine recent administrative and pending legislative reforms to the hydropower licensing process – valuable reforms that took years to achieve. It would also undermine incentives for new hydropower development presently under consideration by Congress.

GAO's draft report to Congress on federal land use fees presents overwhelming substantive, legal and procedural concerns for the hydropower industry. Without question, GAO's recommendations would negatively impact hydropower at a time when policies are being developed to better integrate hydropower into our national energy strategy. Again, NHA appreciates the opportunity to comment on this important matter and hopes our comments will be fully taken into consideration, and the report revised to address our concerns.

COMMENTS OF THE ASSOCIATION

I. ECONOMICS

A. Basing Annual Charges on “Net Benefits” will Result in Unreasonable Increased Costs to Licensees

Implementation of the “net benefits” approach used by GAO would greatly increase the operating costs of many hydro project owners. The sample of 24 non-federal FERC-licensed hydropower projects, as described in the draft report, currently pay a cumulative total of approximately \$2.7 million. Under the GAO “net benefits” approach, these same projects could pay an estimated total of \$157.5 million to \$1.687 billion per year. These figures could correspond to an annual fee increase as much as 875,285% for one project alone.²

Such a significant aggregate fee increase will necessarily be passed along, to the maximum extent possible, to the electric ratepayers who use power from the affected projects. Some electric ratepayers could end up paying as much as 25% more for their electric power without any additional benefit. At a time when electric industry restructuring is increasingly introducing competitive electric power markets in various regions of the country, this has the potential to render hydropower projects economically uncompetitive compared to other power generation technologies.

Estimating the effects of the GAO approach raises other significant economic questions relating to the different types of hydropower project operators. For example, investor-owned utilities subject to cost-of-service rate regulation, municipal or other public power producers, and federal agencies who operate

² This assumes that 100% of net benefits, as calculated by the GAO methodology, are collected as the annual land use fee.

hydropower facilities all pay taxes infrastructure maintenance and construction costs differently, and hence, would experience very different exposure to additional costs under the GAO's approach. This raises concerns about economic equity among the different types of hydropower operators in the U.S.

Even if economic equity issues can be addressed, issues of variability and volatility of economic impacts would still remain. "Net benefits" will fluctuate from year to year at any given project as costs or revenues fluctuate. A project that produces zero net revenue, or that produces a negative net benefit, would be very difficult to handle fairly under such an approach as the GAO uses. These are very serious issues which GAO fails to adequately address in its draft report.

B. GAO's Methodology Yields Anomalous Results

The methodology used by GAO yields anomalous results: for some of the projects, in some years the calculated "net benefit" is negative, not positive. For a few projects, the "net benefit" is negative in most scenarios. GAO attempts to explain this anomaly away, first by pointing out that the methodology forced a cost-of-capital based on an industry average return on investment of 7.22 percent, and then by concluding that negative "net benefits" must reflect a project owner's willingness to accept a lower-than-average return on investment. GAO further states that these projects would eventually be abandoned or shut down, if they are not able to provide a (presumably) competitive return on investment. Finally, GAO obscures the anomaly by ignoring these negative values when calculating the total land rents associated with the 24 projects in the sample used for the report.

There are several problems that are revealed by the appearance of negative benefits. First, negative benefits would imply that the landowner (the federal government acting on behalf of national taxpayers) should receive a less-than-competitive return on its investment in those years or scenarios that show a negative benefit, and should make payments to license holders. However, GAO does not propose that FERC should be provided with funds to actually make payments to licensees under these circumstances, because such a proposal would be ludicrous. Rather, GAO proposes that the landowner should have a preferential interest in the hypothetical "net benefits" of the projects: the landowner should get a share of these net benefits when they are positive, but should not share in the "net benefits" when they are negative.

This thinking undermines the very notion of applying the concept of "fair market value", because in a real market owners of fixed assets face the potential of losing money as well as making money. For example, the owner of a commercial building may face periods of extremely slack demand, when the building is empty and producing no revenues, yet the owner still has to pay property taxes and other operating and maintenance costs. Under these circumstances, the asset owner receives a "negative net benefit"; in contrast, GAO proposes special treatment for the federal landowner, assuring that the risks of ownership are not fully passed on to the landowner.

Second, by excluding these negative "net benefits," GAO overstates the potential land rents that could be assessed, and gives an unrealistically optimistic picture of the potential revenues that the federal landowner could earn. As GAO states, consistent negative "net benefits" could mean that these projects are eventually shut down or abandoned. If FERC imposes exorbitant land rents, based on the GAO methodology, the likelihood of such shut-downs will clearly increase. If FERC imposes an asymmetric land rent methodology, which increases costs in good years but does not provide rebates in bad years, the likelihood of project shut-downs will increase further. Projects that do not operate will not produce "net benefits" at all, and the federal landowner will not receive land rents at all.

C. Land Is Not the Only Fixed Factor of Production

GAO's methodology assumes that land is the only fixed factor of production (input). This is clearly an erroneous assumption in the context of this study. Although before the projects were built, land may have been the only fixed factor, at this point there are many other fixed inputs, including the hydroelectric structures themselves, in some cases water rights that have been acquired, many bridges and roads, fixed hatchery investments and other site improvements, and any other investments with negligible or even negative salvage value. These inputs are also fixed, in the sense that they cannot be picked up and moved to other locations, or put to other economic uses. From this point on, according to the economic theory applied by GAO, these other fixed factors, and not just land, should also receive a share of the "net benefits." In fact, these other fixed factors should receive shares of the "net benefits" commensurate with the nature of the investments that have been made and the risks that have been undertaken. GAO applies its "fixed factor" methodology in a highly selective manner, which demonstrates a bias toward capturing for the federal government a highly disproportionate share of the "net benefits." This cannot be described as an equitable application of the concept of "fair market value".

D. Only Individual Consumers Will Pay for Higher Land Rents

GAO attempts to suggest that there may be circumstances in which shareholders, instead of ratepayers, will end up paying higher land rents. GAO's logic is flawed; ratepayers are the only source of revenues for these higher land rents, except in those few, isolated cases where non-federal hydro projects have already been sold to private entities. To see this, consider two scenarios: (1) the hydro projects remain as part of a regulated utility's rate base; and (2) the hydro projects (in those cases where the licensees are investor-owned utilities) are sold in the future to a private entity as part of a divestiture program. In the first scenario, it is clear that higher land rents will become just another cost of operation, passed along to consumers.

In the second scenario, now that GAO has put potential buyers on notice, the prices bid for hydro projects will be reduced to reflect not only the expected value of the higher land rents, but the volatility in such rents. Reductions in bid prices will automatically reduce the "transition credits" received by ratepayers when the hydro projects are sold to private buyers. That is, the capitalized cost to the buyer of the stream of future, higher land rents will reduce the prices offered for the assets in any divestiture program. Furthermore, higher operating costs in the form of land rents will under some circumstances increase the market price of energy, which will also drive up retail rates. The reduced prices paid for these assets at the time of divestiture, plus the higher costs for energy after divestiture, mean higher rates for ratepayers. Thus, there is no scenario, except where hydro projects have already been sold, in which shareholders would bear any of these additional land rent costs. GAO's conclusion is flawed, and Congress should understand that the entire weight of the higher land rents would fall squarely on the backs of consumers.

E. Rate Impacts in Washington, Oregon and Idaho

GAO alleges that rates in Washington, Oregon and Idaho are relatively low, implying that increases in land rent costs will not be a significant problem. GAO has not recognized the significant increase in retail electricity rates in the Northwest since the fall of 2001, due to the West Coast energy crisis of 2000-01. These retail rates are under continuing upward pressure due to low water conditions in the region, as well as cost increases at the Bonneville Power Administration. For some utilities that would be affected directly by the methodology used by GAO, retail rates are now higher than in many other parts of the country. In part due to these rate increases, unemployment and retail shut-offs have increased. Further increases in retail rates will wreak more havoc on the Northwest economy.

F. GAO Relies on Market Price Indices that Do Not Represent Fair Market Value

For hydro projects in the West, GAO calculates "value" by using a market price index compiled from data associated with transactions at the California Power Exchange (Cal-PX). There are several problems with this approach. First, the Cal-PX no longer is in operation, which means that this market price index is not available. Second, for Northwest hydro projects, output cannot be sold in California without obtaining transmission rights, which are not available on a year-round basis due to previous commitments by transmission owners. Third, even when transmission capacity is available, it is not free. Thus, the Cal-PX index is inappropriate for Northwest hydro projects.

Most importantly, GAO seeks to determine fair market value, but has not evaluated whether this particular index, or any other index, in fact reflects the "fair market value" of the generation. If there is manipulation of the markets that produce these indices, as FERC has recently concluded, then the resulting prices themselves do not represent fair market value, but rather reflect market manipulation. By relying on manipulated price indices, GAO's methodology could produce a windfall profit for the federal landowner.

II. PRACTICALITY AND LOGISTICS

The GAO methodology to determine the "net benefits" for use in assessing federal land use charges at FERC-licensed hydropower projects would create an unprecedented administrative burden and additional reporting requirements and accounting measures for both the FERC and licensees. The current system is efficient and poses reasonable administrative requirements on both the licensee and FERC. More or less, FERC has two staff personnel assigned part time to the work associated with all annual charges under Section 10(e) of the Federal Power Act (FPA). Adopting the GAO methodology would certainly require a major transfer in FERC personnel and resources to handle the workload required on a yearly basis to manage the new program. Likewise, the current system poses a reasonable burden on licensees in terms of record keeping and reporting requirements. The GAO "net benefits" approach, however, would represent an enormous and unnecessary administrative burden on licensees and FERC.

To illustrate some of the questions and difficulties that would arise with implementation of the highly complex "net benefits" approach used by GAO, it's important to look at some of the critical elements that are part and parcel to such a methodology. Basically, it will be impossible to generalize any of the input parameters for a "net benefits" determination for all licensees because each licensee and each project will have distinct financial, operational and maintenance criteria, and the most likely form of alternative generation for comparison purposes will vary significantly from region to region.

For instance, the cost of money for public and private owners of hydropower projects varies according to the type of entity (i.e. state, county, public utility district, irrigation district, cooperative, private utility, industrial company, private entrepreneur, etc). The financing rate for funds varies dramatically for public agencies and other public non-profit entities. Likewise, private companies usually finance in a variety of approaches using a combination of debt and equity that can differ significantly from company to company. In addition, the cost of funds can and does change significantly from year to year. Therefore, this would require each licensee to develop and provide extensive financial data for each annual charge calculation.

In addition, the operation and maintenance (O&M) costs for hydropower projects vary significantly, and are influenced by age, physical location, climate, and many other factors. Therefore, O&M costs fluctuate from project to project and for each individual project from year-to-year. There simply is no general information that would provide an accurate O&M cost for a hydropower project. Each licensee would need to furnish such information on an annual basis.

The value of power from the most likely alternative generating source, a critical input to the GAO's "net benefits" determination, will also change annually due to fuel costs, O&M costs, location, and availability factors. Hydropower projects located in the same area will have substantially different alternative power values based on the source for the alternative that is unique to each licensee, thus creating controversy, and, ultimately, inequities. In some cases there are no alternatives other than hydropower, creating a serious problem in determining one's fees if this aspect of the method is employed.

Furthermore, the GAO methodology does not address the numerous inequities that will occur. For instance, there is no recognition of the entrepreneurial activity associated with constructing the primary facilities that create the value in a hydropower project, namely the dam and power generating and transmission facilities. These major elements of a hydropower project typically represent more than 95% of a project's total cost. Land associated with a hydropower facility represents 5 % or less of the total cost of a hydropower facility in many cases. However, the GAO application of the "net benefits" approach assumes that all the "net benefits" accrue to only the lands, so that for a project located entirely on federal land, up to 100 % of the "net benefits" could be assessed as the annual lands charge, thereby giving no credit for the investment in the important facilities that created the actual benefit. These and other inequities will inevitably result in disputes and litigation.

Federal lands are included within FERC project boundaries for a variety of reasons. Lands devoted to power generation vary significantly and in some cases represent a small portion of the lands subject to annual charges. Large tracts of lands are included for non-power purposes that serve environmental, recreation, and other purposes. Licensees receive no income or value from these lands, yet are charged for their use as part of the FERC project license fees. In addition, the public receives benefits from these other purposes, and thus is already compensated for the use of federal lands by licensed hydropower projects. GAO's methodology completely ignores these other benefits. Furthermore, projects located in the same general area on federal land, and that should have the same approximate value, will have substantially different "net benefits" in light of the different alternative power values, financial costs, O&M and other factors cited above.

Finally, if the GAO methodology is adopted, as stated above, it will be necessary for each licensee to submit on an annual basis extensive financial information, O&M costs, alternative power values, and other information to FERC. With respect to FERC, the agency would need to:

- Implement significant changes in its billing system,
- Conduct over 300 separate "net benefits" analyses every year,
- Make substantial revisions to its efficient computer-driven billing system to account for the variability of its annual charges billings,
- Substantially increase its staff and resources to process and gather the necessary information to perform the time-consuming "net benefits" analyses, and
- Process complaints, disputes, or litigation associated with the annual charge analyses.

In summary, the GAO methodology, if adopted, will create an entirely new system with extensive record keeping and reporting requirements that will substantially increase the administrative burden on FERC and the hydropower industry. What's more, the GAO methodology will be inherently unpredictable and inefficient, problems that the current system was designed to avoid. Disputes regarding computations, data, inequities, and other problems will inevitably result in complaints, disputes, or substantial and prolonged litigation.

III. LEGAL IMPLICATIONS

A. The GAO Methodology is Inconsistent with the Federal Power Act, Because Fair Market Value is Not a Basis for a Reasonable Fee

FERC's authority to impose annual charges upon licensees comes from the Federal Power Act, Section 10(e), which, in relevant part, provides:

“That the licensee shall pay to the United States reasonable annual charges in an amount to be fixed by the Commission for the purpose of reimbursing the United States for the costs of the administration of this Part; for recompensing it for the use, occupancy and enjoyment of its lands or other property; ... and in fixing such charges the Commission shall seek to avoid increasing the price to the consumers of power by such charges, and any such charges may be adjusted from time to time by the Commission as conditions may require: ...”

Section 10(e) goes on to provide that reasonable annual fees for the use of tribal lands and government dams will also be imposed by FERC. However, those fees are subject to approval by the Secretary of the Interior for dams in reclamation projects and by the Indian tribe for tribal lands.

Fair market value is not a reasonable fee. The GAO indicates the “net benefits” method is designed to obtain fair market value for the use of federal lands by a licensee. However, the FPA §10(e) requirement for land fees is **not** tied to fair market value. In fact, fair market value is a greater value than the “reasonable annual charge” set out in FPA §10(e). In *City of Vanceburg v. FERC*, the Court of Appeals considered the question of whether FPA §10(e) charges for the use of a governmental dam were reasonable. The court reasoned:

“[T]he Commission must set a reasonable charge by considering all relevant factors and arriving at a charge which minimizes consumer costs, encourages power development, but at the same time, compensates the Government to some extent for the benefit it has conferred on the licensee.³”

In upholding the fee, the court indicated that FERC must consider a number of different factors in setting the fee, including factors that would necessarily result in a fee below the “fair market value” of the federal land. For example, if FERC were to always focus on a fee that met the fair market value of the federal land, the Commission would fail to take into account the FPA §10(e) direction to “seek to avoid increasing the price” of power to consumers. FPA §10(e) does not promote a fair market value standard. In fact, the court in *City of Vanceburg* also stated:

“[W]e do not suggest that the Commission is free automatically to assess as charges the full amount of the value conferred on a licensee.⁴”

In the draft report, GAO recognizes the Federal Power Act's requirement that FERC balance competing interests in setting its fees. However, the use of fair market value and the “net benefits” analysis installs a baseline that is unreasonable from the start. Although GAO does not recommend that a certain percentage of the “net benefits” from a project go to the United States, the report points out that FERC has frequently used a 50/50 split to determine the benefits from the licensee's use of tribal land and the use of a government dam. Further, even if FERC were to use a smaller percentage in determining the amount of the annual charge for federal land, the GAO formula is still based on determining the value of the land

³ *City of Vanceburg v. FERC*, 571 F.2d 630, 647 (D.C. Cir 1977).

⁴ *Id.*

through the determination of the “net benefits” obtained by the licensee through the operation of the hydro project.

B. The Annual Fee for Federal Lands Must Be Calculated Differently From the Fee for Use of a Government Dam

Although the annual fee for the use of federal lands will compensate the United States for the benefit conferred upon the licensee, the reasonable fee amount should not be calculated in the same manner as the fee for the use of a government dam. The *Vanceburg* court explained that a national average rental value is appropriate to compensate the government for the use of federal lands, which is the benefit derived from a “fungible tract of real estate”.⁵ The use of water at a specific government owned dam provides a much larger benefit upon the licensee because the licensee need not construct or operate the dam.

In the case of federal land, the land could be, and generally is, used for authorized purposes (other than hydropower). Also, the licensee must construct, operate, and maintain all the necessary project works. Thus, the benefit conferred upon the licensee by the use of federal land is fundamentally different. However, the “net benefits” method would treat the use of federal land similarly to the use of a government dam.

Moreover, the compensation method for the use of government dams has significantly changed - now requiring a graduated charge in mills per kilowatt-hour based upon the amount of energy provided. 18 C.F.R. §11.3. Using the “net benefits” approach for government lands could result in a higher fee paid by users of federal lands than users of government dams.

C. The Use of a Royalty Type Fee is Inappropriate

FPA Section 10(e) is not “intended to be a general revenue raising statute”.⁶ When previously addressing the appropriate method for calculating annual charges, FERC concurred with this conclusion and determined:

“that a percentage of gross sales fee or a flat rate per kilowatt hour fee is not a reasonable method of assessing land use charges. The tiered system suggested by the Forest Service is also unreasonable, as it would charge a royalty for run-of-river projects as though the Federal land being used was producing the power. This overlooks the fact that many projects use a combination of federal and private lands, and that the power output is a result of many factors (water rights, head, project structure) and not just the acreage of federal land involved.”⁷

The GAO analysis contains the very defects that caused FERC to dismiss similar valuation methods in the past. Moreover, the GAO method assumes that the federal lands contribute equal value to a hydro project’s ability to generate power compared to the other private lands upon which the project is located. Unlike the use of a government dam, which directly enables a hydro project to divert water and generate power, the use of federal lands may or may not provide that benefit. FERC would need to conduct a case-by-case analysis of each hydro project to determine the value provided by the use of the federal lands. The GAO method does not propose such a case-by-case approach and its arbitrary division of value based upon the acreage of federal land occupied is inappropriate.

⁵ *Id.* at 646.

⁶ *Id.* at 643.

⁷ Revision of Billing Procedures for Annual Charges for Administering Part I of the Federal Power Act and to the Methodology for Assessing Federal Land Use Charges, 52 Fed. Reg. 18,201, 18,206 (May 14, 1987).

D. The Sharing of the “Net Benefits” Method Does Not Accurately Consider the Actual Value of the Property

Importantly, determining the value of the federal lands used by the licensee should not be tied to the generation benefits that will be derived from the project. The benefits conferred upon the licensee by the land should be no different from the benefits conferred upon any other user of that federal land. The federal land’s value is the value of its “highest and best use”. This entails determining the “highest and best use” of the land at the time it was acquired or, at most, its likely use in the reasonably near future.⁸ This value may be established by the use of comparable sales, or the average rental values of comparable lands. Court decisions dealing with the condemnation of land for hydro projects have reached this same conclusion. In *Public District No. 1 v. City of Seattle*, 382 F.2d 666, 673 (9th Cir. 1967), the court stated:

“Power value may generally be said to be of two types. First, there is the value increment which one engaged in the assembling of lands needed for a power project would be willing to pay in order to include such land in its needed package. *Such values typically are established by proof of comparable sales.*” (emphasis added).

The court went on to conclude that the profit that could be achieved from a power project was not an appropriate valuation method because it assumed that the property would be put to use as a hydroelectric project by the federal government in the near future. *Id.* The FERC would not have licensed a hydro project to a private party if the United States had plans to construct the hydro project. Consequently, the federal government may not now argue that hydropower was the highest and best use of the project. Assuming the federal land had value as a power generation source is not a valid method for calculating the annual charge for the use of the federal land.

Instead, the GAO report should consider the process by which the federal government determines the amount of compensation it would pay for private land acquisition. These federal acquisition guidelines require the use of comparable sales.⁹ It also notes that the preferred way to appraise a leasehold estate is to use comparable lease transactions.¹⁰ The FERC licenses are roughly equivalent to a land lease. Therefore, the value of the federal lands should be determined based upon the highest and best use of the lands before the lands were withdrawn for power purposes pursuant to FPA Section 24.

If the United States desires to obtain the power generation value of the federal lands, the FPA provides a mechanism to achieve that goal. FPA Sections 14 and 15 allow the United States to takeover a hydroelectric project at the end of the current license term. Allowing the federal government to impose the charges contemplated by the sharing of the “net benefits” method essentially gives the government 50 percent of the generation benefits created by a hydroelectric project without assuming any of the hydro project’s risks and without compensating the licensee for this “taking.” In other words, the GAO method gives the government over one-half the benefits envisioned by a take-over without the accompanying FPA responsibilities.

F. The GAO Method will Result in Significant Increases in Costs That Will Be Reflected in Electric Rates

The GAO method, if adopted by FERC, would admittedly result in increased annual charges paid by hydro project licensees. These costs must be accounted for in some fashion. Most municipal hydro

⁸ *United States v. Buhler*, 305 F.2d 319, 328 (5th Cir. 1962); *Olson v. United States*, 54 S. Ct. 704, 708-708 (1934).

⁹ Uniform Appraisal Standards for Federal Land Acquisitions, Proceedings, Interagency Land Acquisition Conference (2000) at p. 25 (stating that land is to be valued on the use of comparable sales).

¹⁰ *Ibid*, p. 61.

project owners and the majority of public utilities continue to pass through their hydro operation and maintenance costs along to their customers. This applies to private utilities as well. The increased charges for the use of federal lands will then cause consumer prices for electricity to increase. FPA Section 10(e) clearly instructs the Commission to avoid price increases to consumers.

IV. PUBLIC POLICY IMPLICATIONS

There are several public policy implications tied directly to FERC's potential use of the GAO methodology for determining fair market value for use of federal lands in assessing annual charges. The most notable are:

- a massive failure to adequately recognize the many valuable benefits our nation's leading renewable resource offers the American public;
- the creation of yet another barrier to further developing this underutilized but indispensable energy resource;
- the loss of hydropower generation and an increase in pollution from less clean alternate energy sources; and
- an increase in electricity costs.

A. GAO's Methodology Ignores or Fails to Capture the Many Benefits of Hydropower

Hydropower offers the American public a tremendous number of valuable benefits. These benefits include, but are not limited to, low cost and pollution-free power supply, transmission system reliability, energy security, flood control, water supply, recreation and irrigation. In addition, projects licensed by FERC contribute to improved environmental and natural resource quality through protection, mitigation and enhancement measures conducted by licensees on their own or through license conditions issued by FERC. The industry has spent hundreds of millions, if not billions, of dollars enhancing the environment and providing recreation and other benefits for the American public.

One of the presumptions of GAO's report is that the federal government and the American taxpayer is coming up short due to today's system to collect federal land use fees. On the contrary – the American public and the taxpayer are gaining numerous invaluable benefits from use of federal land for hydropower production. In its attempt to capture fair market value, GAO's methodology largely ignores or inaccurately captures these very important benefits when calculating the project's "net benefits." GAO's methodology does not consider what the American public gains when federal lands are used by hydropower owners and operators, whether these benefits were created by actions of the licensee, directed by FERC or federal resource agencies, or occur naturally as a result of using America's rivers to generate clean electricity. The GAO methodology instead focuses solely on the project owners' financial or "special benefits" – what the owners and operators are gaining financially for use of federal land to generate electricity.

When issuing licenses, however, FERC weighs all interests and adopts license terms and conditions to achieve a project that is well-suited to a comprehensive plan for the waterway. It does not focus solely on economics, as GAO does in its draft report. One of the ways in which the Commission achieves a balanced project is by requiring licensees to pay annual charges. The payment of annual charges is not a separate and distinct feature of the FPA. It is only one aspect of an overall framework of developing hydropower facilities that meet many public uses. Similarly, potential federal land use fees should be adjusted to recognize the public benefits provided by the projects, such as recreation, flood control, irrigation, navigation, water supply, fish and wildlife enhancement, etc. The current system for collecting

land use fees captures these benefits and recognizes the value to the American public of using federal lands for hydropower generation. GAO's methodology, however, does not.

The "net benefits" approach used by GAO does not account for these public benefits in all instances. For example, the net benefit methodology calculates, for each project, the cost of generating hydropower. This calculation may account for some public benefits provided by the project, such as operation and maintenance costs for recreational facilities. However, many of the more costly license terms that reduce production at the facilities would not be included in any cost calculation.

For instance, many license conditions require the licensee to forego the use of some of its water to provide for in stream flows for whitewater rafting and fisheries enhancement. Other license conditions establish minimum and/or maximum reservoir levels to provide for recreation, flood control, and/or fisheries. All of these license conditions constrain the ability of licensees to operate their projects at a higher capacity. Yet, FERC Form 1 and EIA Form EIA-412, which GAO uses in its net benefit methodology, are not sufficiently sensitive to these concerns to yield useable and reliable data necessary to make these calculations. Because such constraints would not be included in the "net benefits" calculation, the methodology does not capture the expense associated with these public benefits.

In addition, FERC recognizes that hydropower projects possess benefits not present in fossil sources of generation. Many hydro projects serve peak loads and provide valuable ancillary services due to the unique nature of hydropower generation and its ability to dispatch electricity quickly. This is not the case for all facilities, however, as some plants are non-dispatchable or run-of-river facilities. Other methodologies could take these unique factors into account, but GAO's methodology fails to do so, again highlighting the inadequacy of the analysis and its inability to capture hydro's benefits.

Congress and the administration have been working to devise hydropower policies that better recognize, and better balance, our nation's energy needs and important environmental goals. Significant progress has recently been made on these fronts through legislative and administrative improvements in the hydropower licensing process. In addition, Congress is considering incentives to tap into the large amount of unused hydro capacity in the U.S. Adopting the GAO "net benefits" recommendation would amount to nothing less than a significant step backwards in recognizing and valuing the contributions of our nation's hydropower resources in meeting our energy and environmental policies. By failing to capture or accurately recognize the many contributions hydropower makes to clean air, a sustainable future and a higher quality of life for American citizens, the GAO methodology fails to serve the American public and would jeopardize progress made on critical hydropower issues of late. It is a major flaw that cannot be overlooked.

B. Adoption of the Methodology Would Discourage Hydropower Development

The GAO's "net benefits" methodology also discourages hydropower development, an already underutilized resource. FERC and the courts have long found that one of the main purposes of the FPA is to encourage hydropower development. One of the primary mechanisms to encourage development is for FERC to issue licenses with fixed terms sufficient to make the licensee secure in its investment. The FPA itself precludes unilateral changes to license terms and conditions by FERC or Congress. Even upon expiration of a license, FERC cannot simply change license terms in the new license without providing reasoned explanation.

To comply with this underling policy of the FPA, the Commission has chosen a straightforward, transparent means to calculate its federal land-use rents and has specifically rejected a more complex, cost-based system. In fact, FERC has previously rejected the "net benefits" approach on the basis that it would not serve the goal of encouraging hydroelectric development. In changing its methodology for

collecting fees for the use of government dams from a “net benefits” approach to a flat rate approach, the Commission found that the flat rate approach:

“is relatively simple and straightforward both for the Commission to administer and for potential developers to factor into their project feasibility studies. This will enhance the certainty of hydro project development...A flat rate method does not require the complex calculations inherent in the generic [net benefits] method...This complexity would interfere unnecessarily with the Commission’s need for administrative workability and licensees’ need for predictability.”

Because the “net benefits” approach calculates a charge using data points that would likely fluctuate from year-to-year, its use would conflict with policies of the FPA that require certainty and predictability regarding licensees’ obligations under the terms of their licenses. Considering the volatility of the electric market from year-to-year, the uncertainty of these costs would interfere with prudent utility management and long-term planning and budgeting. Certainly, this effect would be inconsistent with the broad policy of the FPA to encourage hydroelectric development.

NHA forecasts that 21.3 Gigawatts (GWs) of additional power from hydroelectric resources could be developed by 2020 – none of which would require the construction of a new dam or impoundment. In terms of greenhouse gas reductions, this would equal displacing 24 million metric tons of carbon emissions. Of the 21.3 GWs, over 4,300 MWs of “incremental hydropower” could be developed, meeting today’s environmental standards at *existing* hydropower facilities through capacity additions and efficiency improvements. This is enough power for approximately four million homes – clearly a significant contribution to our nation’s energy supply. Adoption of GAO’s methodology would undermine attempts to develop this great renewable potential.

At a time when the administration and Congress are designing policies to increase our usage of domestic energy resources, including hydropower, policy analyses, such as GAO’s, would discourage and seriously undermine our ability to tap into unused hydropower capacity, should be strongly discouraged and rejected. GAO’s approach to land use fees is inconsistent with the administration’s National Energy Policy and Congress’s intent as it debates a comprehensive national energy policy. What’s more, the American public has spoken to the issue of encouraging additional hydropower development – 74% of registered voters support incentives from the federal government to further develop our existing hydropower infrastructure.¹¹ As Congress, the White House and the American public have realized, we need to encourage additional hydropower development. GAO’s “net benefits” methodology does just the opposite, and that is a shortsighted and ill-advised policy to pursue.

C. GAO’s Methodology Could Lead to the Loss of Hydropower Generation and an Increase in Pollution and Electricity Costs

Adoption of the “net benefits” approach could also lead to the loss of hydropower generation and an increase in pollution and higher-priced electricity. As we outlined earlier in our comments, the financial impacts of the “net benefits” approach could be devastating for certain hydropower projects. If adoption of this methodology led to the shut down of hydropower facilities or a significant loss of clean megawatts, those facilities and its megawatts would likely be replaced with natural gas-fired or fossil power plants that emit greenhouse gases and would cost more in terms of electricity prices. Pursuing a policy that would create such a scenario is irresponsible, at best. The American public should be faced with neither of these choices – more pollution or higher electricity prices. At a time when air pollution,

¹¹ This poll of 1,000 nationwide, registered voters was conducted between January 19-27, 2002, by Bisconti Research, Inc. and contains a margin of error of +/- 3 percentage points.

greenhouse gases and electricity prices are of major concern, we should pursue policies which remedy these concerns, not exacerbate them, as the GAO “net benefits” methodology would surely do.

D. GAO’s Methodology Would Require Congressional Action and a Major Shift in Energy Policy

Congress specifically structured the FPA not to require the collection of the full “fair market value” of federal lands used for energy production. Instead, the FPA is intended to meet policy goals other than recouping the United States for the full “fair market value” of its lands. As discussed above, the FPA is intended to encourage efficient administration, encourage hydropower development, ensure low-cost rates to consumers, and consolidate all hydropower regulatory authority in FERC. FERC’s current system of collecting federal land-use rents is firmly rooted in all these policies.

Of course, Congress could implement changes, but even a seemingly simple amendment to require the collection of Federal land-use rents at “fair market value” would require a fundamental shift in policy. Indeed, under the FPA, Congress did not intend FERC to collect these charges at full “fair market value.” When Congress desires an agency to recover land use fees at “fair market value,” it specifically provides for such recovery. For example, many Federal statutes – such as the Federal Land Policy and Management Act, the Mineral Leasing Act, and the National Forest Ski Area Permit Act of 1986 – specifically require Federal agencies to recover “fair market value” for the use of Federal lands. However, Congress may dictate a standard other than full “fair market value,” as it has done in the Federal Power Act. In fact, the Office of Management and Budget’s (“OMB”) Circular No. A-25, which implements Title V of the Independent Offices Appropriation Act of 1952, recognizes that Congress may establish a standard upon which to collect user fees other than full “fair market value.” The GAO has even recognized in the subject report that a standard other than full “fair market value” may apply to federal land-use rents.

Indeed, Congress often requires standards other than the full “fair market value.” For example, the Land and Water Conservation Fund Act requires land-use rental charges to be “fair and equitable.” Similarly, the Taylor Grazing Act of 1934 requires holders of grazing permits to pay “annual reasonable fees.” The same holds true for the FPA. In establishing cost recovery for the use of federal lands under the FPA, Congress specifically chose standards other than “fair market value.”

Section 10(e)(1) of the FPA provides for licensees to “pay to the United States *reasonable annual charges*...for recompensing it for the use, occupancy, and enjoyment of its lands or other property...” Moreover, Section 10(e)(1) also sets the standard that “in fixing such charges the Commission shall seek to avoid increasing the price to the consumers of power by such charges...” Together, these standards in Section 10(e)(1) establish that Congress intended for the Commission not to collect in annual charges the full “fair market rental value” of Federal lands. As explained by the Court of Appeals for the District of Columbia Circuit:

“[W]e do not suggest that the Commission is free automatically to assess as charges the full amount of the value conferred on a licensee . . . [T]he Commission must set a reasonable charge by considering all relevant factors and arriving at a charge which minimizes consumer costs, encourages power development, but at the same time, compensates the Government to some extent for the benefit it has conferred on the licensee.”

Thus, Section 10(e)(1) embodies the fundamental policies of the FPA, such as encouraging hydropower development and ensuring low-cost power to consumers. If Congress were to determine that these policies should give way to an overriding policy that favors full recovery of federal land-use rents, it would have to specifically authorize FERC to collect federal land-use rents at fair market value. This

would mark a major shift in policy that has been recognized and pursued for over 80 years. What's more, it would directly conflict with current efforts by Congress to devise legislative solutions to prevent unreasonable increases in granted, issued or renewed rights-of-way fees associated with deployment of telecommunications and other critical infrastructure on federal lands. This would force Congress into pursuing two very different paths with regard to land use and rights-of-way fees paid by various industries.

V. CONSISTENCY WITH SOUND ACCOUNTING PRACTICE

It is important that the underlying accounting philosophy used by the GAO be sound. First, it is desirable to provide equitable compensation for the land owner. Second, it is important that land use fees are determined in a way that does not distort the economics of existing projects or potential future projects. If land use fees are inappropriately high, the development of new projects and the expansion of existing economical, renewable energy projects would be discouraged.

The GAO methodology does not correctly allocate the benefits of the project. When accounting for the value of land that is developed for its natural resources, there are generally three components that must be included: 1) acquisition, 2) exploration, and 3) development. By essentially prorating the value of the project on the basis of land ownership only, the GAO methodology ignores that substantial contributions have been made to the value of the land by development of the project and project improvements. If benefits of the project are to be allocated to the various capital components, then value should not be assigned solely to the land but should be further allocated among the other capital contributions. Further, beyond the need to recognize the contributions from capital, there must be recognition of and return provided for entrepreneurial risk. To illustrate the problems with the GAO methodology, consider the case at the extreme where 100% of project land is federally owned. The GAO methodology would not provide for allocation of any benefits to exploration and development, nor to entrepreneurial risk, nor to any other fixed investments that have been made in the projects.

Conflicts between the GAO methodology and sound appraisal practices are discussed elsewhere, but it should be noted that the GAO methodology is in conflict with accounting valuation practices as well as appraisal practices. Land value is most often established for accounting purposes based on historical cost, but other means of valuation are used. An alternative, fair market value (defined as what is given up to acquire the land or its own fair market value) is more consistent with current methodologies than the GAO methodology.

VI. CONSISTENCY WITH SOUND APPRAISAL PRACTICE

A. Present Methodology Used for Valuing Federal Hydro Land

In order to better understand the inconsistency between the "net benefits" methodology and established appraisal practice, it is important to understand the current method being used. In 1987, FERC adopted its current methodology of using a published United States Forest Service index of values of transmission rights of way in order to determine the annual charges for use of federal land on FERC-licensed hydroelectric projects under Section 10(e) of the Federal Power Act.

The Forest Service fee schedule is based upon a survey of market values for the various types of land that the Forest Service has allowed to be occupied by linear rights of way.¹² The schedule is divided into regional zones and provides per-acre rental fees by state and county. These fees are arrived at by

¹² Revision of Billing Procedures for Annual Charges for Administering Part I of the Federal Power Act and to the Methodology for Assessing Federal Land Use Charges at 18,205.

multiplying the raw value of the land in each zone by an unspecified rate-of-return.¹³ The rates are adjusted downward to reflect the value difference between rights-of-way authorization granted by private landowners and those issued by the government. Because of encumbrances on federal land, it was valued approximately 70 percent less than similarly situated private land. The result is an annual fee per-acre per-year for lands used for electric transmission lines; the fees range from \$2.24 for land in Nevada to \$44.87 a year for land in some counties in Florida.¹⁴ Because the Forest Service index is a rate for charges for transmission rights of way, the Commission doubled the fees in the index in order to derive a charge for project lands, explaining “transmission line rights-of-way will be assessed at the Forest Service index rate and other project land will be assessed at twice that rate.”¹⁵ This doubling of the fee schedule reflects the reduced residual utility of forestland devoted to hydroelectric project use as opposed to transmission corridor use.

In essence, the FERC’s present methodology is based upon “across the fence” values. The use of an “across the fence” methodology captures the values of land with similar characteristics to the land being valued, and appraisers throughout the country routinely rely upon it because it establishes a value of land based upon comparable sales. Because the value of the subject land is based upon sales of other like pieces of land, the FERC present methodology correctly calculates rental fees based on the value of the land being used.

B. A History of Methodologies Used to Value Federal Property Used in Hydroelectric Projects

It is also important to understand the history of past methodologies when considering revisions. Since 1938, the Commission has established fees for hydroelectric licensees’ use of federal land using various methodologies. From 1938 until 1942, the Commission based the fees on a project-by-project basis. This method proved to be uneconomic because of the excessive costs of the appraisal in comparison to the value of the land involved. Consequently, in 1942 the Commission developed a national average value of \$50 an acre, and recognizing that the Federal land was being used rather than purchased, approximated a rental value by selecting an interest rate as a rate of return that could be multiplied by the value of the land to determine a fee. The Commission chose an interest rate of four percent, thereby deriving a rental rate of \$2.00 per acre. Twenty years later, in 1962, the Commission increased the average value per acre of federal land to \$60 but retained the four percent interest rate, thereby increasing the annual land use charge to \$2.40 per acre. Then, in 1976, in Order No. 560, 56 F.P.C. 3860, the Commission increased the national average value to \$150 per acre and adopted a fluctuating interest rate used by the United States Water Resources Council which was based on the average yield of long-term (15 or more years to maturity) United States interest-bearing securities.

In 1986, the Commission abandoned its traditional methodology of multiplying a national average per-acre land value by a rate of return as the basis for calculating the fees in favor of the Forest Service fee schedule discussed above.¹⁶ In doing so, the Commission analyzed and rejected various proposed

¹³ Although the order states that the calculation of the rate of return is “discussed below,” there is no such discussion in the order.

¹⁴ Revision of Billing Procedures for Annual Charges for Administering Part I of the Federal Power Act and to the Methodology for Assessing Federal Land Use Charges at 18,205.

¹⁵ *Id.*, and 18 C.F.R. § 11.2 (B).

¹⁶ The impetus behind the change was a study by the Inspector General of the Department of Energy that determined that the Commission had been undercharging licensees by approximately \$15.2 million each year for the use of about 168,000 acres of Federal land. The Inspector General recommended revising the Commission’s regulations to

methodologies, including a charge assessed on a per-kilowatt-hour basis. The rejected per-kWh hour approach determined the fee by looking to the generating capability of the entire property—the land and the facilities on the land. Specifically, the methodology used by GAO determined the total income that the entire property could generate and assigned a percentage of that income to the land as rent. Consequently, the fee would have been based upon the income generating capacity of the particular property and *not* the value of the land itself. In its rejection of this income-based approach, the Commission stated that it --

“[A]grees with most of the comments that a percentage of gross sales fee or a flat rate per kilowatt hour fee is not a reasonable method of assessing land use charges. The tiered system suggested by the Forest Service is also unreasonable, as it would charge a royalty for run-of-river projects as though the Federal land being used was producing the power. This overlooks the fact that many projects use a combination of Federal and private lands, and that the power output is a result of many factors (water rights, head, project structure) and not just the acreage of Federal land involved. For these reasons the Commission decides not to adopt the above fee methodologies as a means of assessing land charges.” 52 Fed. Reg. at 18,203.¹⁷

C. Accepted Appraisal Practice

The GAO methodology conflicts with the Uniform Standards of Professional Appraisal Practice (USPAP) as established by the Appraisal Foundation. These standards were mandated by Congress and are the most authoritative text in the valuation of real estate and are the generally accepted standards for professional appraisal practice in North America. USPAP contains standards for all types of appraisal services. Standards are included for real estate, personal property, business and mass appraisal. The preparation of USPAP standards is overseen by the Justice Department and these are the standards required for most federal land transactions.

USPAP was originally written in 1986-1987 by an appraisal profession Ad Hoc Committee on Uniform Standards and was donated to The Appraisal Foundation in 1987. The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 cites USPAP as the standards to be enforced by state real estate appraiser licensing agencies. USPAP compliance is also required by professional appraisal associations, client groups and by dozens of federal, state and local agencies. It contains the Standards of Practice for all appraisal disciplines (real estate, personal property, business and mass appraisal).

USPAP is released on an annual basis. Regulators base enforcement decisions on the edition of USPAP in effect as of the date of an appraisal report. It is enforced by regulatory agencies, professional appraisal associations and client groups; and is growing in acceptance throughout the world. Many professional associations in Central and South America, Europe and Asia have accepted and adopted USPAP as the standard of practice for their membership.

USPAP notes that the methodology to be used when determining the value of a subject property varies depending on the type of property being appraised. For example, when determining the value of a facility that includes both real and personal property, such as a hydroelectric facility, the appraiser would consider all three approaches to value: the income approach, the sales comparison approach, and the cost

base such land use charges on the current fair market value of the land being used and the current long-term government-borrowing rate. The Inspector General also recommended replacing the national average land value with state-by-state averages. See Assessment of Charges Under the Hydroelectric Program, DOE/IG Report No. 0219 (Sept. 3, 1986).

¹⁷ The Commission also rejected other methodologies, such as using agricultural land values as a proxy or individual appraisals. Id. at 18,202-05.

approach. When using the income approach, the appraiser does not attempt to separate out the value of land from the other assets being appraised; instead, the facility is valued as an income-producing unit. Similarly, when conducting a comparable sales analysis for the facility, the appraiser compares sales of comparable facilities and does not separate out the value of the land.

On the other hand, when determining the value of an individual piece of real estate, such as land to be included within the boundaries of a hydroelectric project, an appraiser typically determines value by examining comparable sales of parcels of land with identical or similar physical characteristics. Thus, the value of the subject property, the land, is based upon sales of comparable property. This is the approach recommended in appraisal texts and courses. The appraiser would not, utilizing accepted appraisal theory and practice, attempt to calculate the value of the real estate by using an approach that values the entire facility.

The GAO “net benefits” methodology appears to violate USPAP. In Standard 1: Real Property Appraisal, Development, Standards Rule 1-4 states that “an appraiser must: develop an opinion of site value by an appropriate appraisal method or technique.” Here, the “net benefits” methodology values the land by looking at the income producing potential of the entire project and assigning a portion of the income value to the real estate. As explained above, the GAO methodology does not appear to be an appropriate appraisal method or technique to develop a site value. USPAP identifies the sales comparison approach as the most appropriate approach when determining the value of land.

Further, Standards Rule 1-1 states that “In developing a real property appraisal, an appraiser must: be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal; not commit a substantial error of omission or commission that significantly affects an appraisal; and not render appraisal services in a careless or negligent manner...”. The Uniform Appraisal Standards for Federal Land Acquisitions, a document prepared for appraisers to utilize in preparing valuations for acquiring agencies on behalf of the United States, quotes case law, stating “historically, the capitalization of income approach to value has been suspect”¹⁸. Using the income capitalization approach requires appraisers to use “...a myriad of factors and variables, the accuracy of which cannot clearly and easily be demonstrated by market data”. The “net benefits” approach is admittedly uniquely different from similar methods used in Canada to value hydroelectric projects (Canada capitalizes the “net benefits” over the life of the project – not each year). If the FERC projects are valued each year with the knowledge of the Canadian process using the life of the project as well as previously approved processes, the resulting valuations could be deemed to have been performed in a careless and negligent manner.

This “variant” of the Income Capitalization Approach would not use the actual income produced from the hydroelectric projects. Instead, it would use market prices of the hydropower produced by the projects to assign a market value to the land. These market prices will greatly fluctuate each year, be subject to uncontrollable market manipulations (as seen in California in 2000) and would not be a proper basis to determine a project’s market value. Again, the Uniform Appraisal Standards for Federal Land Acquisitions notes that conjectural and speculative evidence of market value should not be considered.

D. Federal Appraisal Practices

The purpose of Title XI SEC. 1101 of FIRREA [12 U.S.C. 3331] is to provide that Federal financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose

¹⁸ *Foster v. U.S.*, 2Cl. Ct. 426, 448 (1983).

professional conduct will be subject to effective supervision. Most Federal real estate transactions should be carried out in accordance with the standards set by USPAP. As discussed above the “net benefits” approach is not consistent with the requirements of USPAP and its implementation will set conflicting standards for Federal Government transactions.

The “net benefits” methodology is flawed. Its application would very likely lead to varying and arbitrary federal land use charges. Its application would be in conflict with the direction Congress has established under PURPA for the consistent application of Federal real estate transactions. This variation of land rents would not be related to the value of the land itself but, rather, on a variety of other factors. The current methodology is a well-recognized valuation methodology and does not violate appraisal theory or application. The value of the land is based upon the value of similar or comparable land. In addition, the current fee-schedule methodology accounts for the fact that Federal land is encumbered in a manner that private land is not, and therefore, has a lower value.

Moreover, if the licensee were able to purchase or condemn the federal land on which the project is located, it would most likely do so, and the resulting "just compensation" owed would be the upper limit of the value of the land. Because federal land is not subject to condemnation, however, the licensee is, in a sense, held hostage by the federal government. Application of the “net benefits” methodology would cause some licensees to pay rents substantially higher than what would be owed to a private landowner notwithstanding that the federal land is likely worth less than comparable private land because of governmental regulations and restrictions.

VII. CONCLUSION

Though the GAO, in its draft report, does not recommend a particular formula for assessing federal land use fees, the determination of fair market value through the use of a “net benefits” calculation establishes a baseline for discussion that NHA believes is fatally flawed, misleading and unfair to consumers. Again, NHA does not believe the “net benefits” methodology is applicable to determining the value of federal lands to a FERC-licensed hydropower project. As such, NHA strongly encourages FERC, should the Commission decide to revisit its program for collecting annual charges, to reject the GAO’s “net benefits” approach. NHA also believes Congress should reject the GAO’s “net benefits” analysis contained in the draft report as it undermines the nation’s oldest, largest and most reliable renewable resource.