BEFORE THE NORTH CAROLINA

ENVIRONMENTAL REVIEW COMMISSION

Re: SB 1046: An Act to Study the Impacts on the State of North Carolina of the Potential Issuance of a Fifty-Year License by the Federal Energy Regulatory Commission for the Operation of the Yadkin Hydroelectric Project.

BRIEF OF STANLY COUNTY

EXECUTIVE SUMMARY

Alcoa cannot operate the Yadkin Project without a federal hydropower license. Such licenses are of limited duration—Alcoa's Yadkin license expired in April 2008—and the federal hydro relicensing statute provides several ways for the State to gain better control of the flows of the Yadkin River when a license expires. These methods are explained herein, in the context of the current Yadkin relicensing proceeding. It should be noted that insofar as FERC is concerned, the relicensing process is about over, and FERC is ready to make a decision. However, FERC has failed to explore the issues of concern in SB 1046, despite the federal statute requiring it to consider local impacts in its relicensing decisions.

The law provides opportunities for the State to better control the use and allocation of the Yadkin River flows for the next fifty years in the public interest, but in the absence of prompt action by the State, the law also provides that the exclusive right to control the Yadkin River flows and receive virtually all of its substantial benefits will go to a private corporation.

INTRODUCTION

Senate Bill 1046 directs the Environmental Review Commission ("ERC") to study the impacts on the State of North Carolina if the Federal Energy Regulatory Commission ("FERC") grants Alcoa Power Generating, Inc. ("Alcoa" or the "Corporation") another 50-year license to operate the Yadkin Hydroelectric Project. SB 1046 also authorizes the ERC to consider and develop proposals regarding the following issues:

(1) The socioeconomic impacts of Alcoa's decision to discontinue its job producing manufacturing activities at its Badin facility that relied on the use of low-cost power from the Yadkin Hydroelectric Project.

(2) Assurance of an adequate, clean future water supply for the region.

(3) The allocation of water for non-power uses from the Yadkin Hydroelectric Project.

Stanly County believes that the ERC's task can best be met by first examining the relevant facts, some of which are known only to Alcoa. The ERC should ask Alcoa for that information, much of which has not been disclosed to the public. Second, the federal law governing the relicensing of hydroelectric projects provides options available to the State to better enable it to assure the public of an adequate, clean future water supply for the Yadkin River Basin watershed and to better assure the allocation of waters for non-power uses from the Yadkin Project, for use within the State without the obligation in the future to pay Alcoa, the present Licensee, for such uses or to seek the consent of Alcoa to implement such decisions. Third, it is critical to appreciate that the State, through its water quality certificate permitting process, plays an important part in the State's options and the likely outcome of the federal relicensing process.

In Stanly County's view, the ultimate purpose of the ERC's study is to determine whether the State must take some specific action to assure that it regains the primary authority to control the use of the flows of the Yadkin River, one of the major rivers in the State, for the benefit of the citizens in the State or whether, by failing to be informed and to take any action, the State will allow primary control of the Yadkin River flows to be granted, by default, for the next fifty years to a private corporation with a fast-vanishing presence in the State.

To assist the ERC in its work, Stanly County submits this Brief, discussing the four major areas it believes critical to the Commission's work:

(1) The basic information, some of which is not public, that the ERC needs from Alcoa about the actual costs to the Corporation of operating the Project; the value of the Project output the Corporation anticipates over the next 50 years; Alcoa's internal documentation about the extent of contamination at the Badin site and other affected project areas, and the costs of applying best technology to restore the site and waters to unrestricted use; and the facts and background underlying Alcoa's failure to comply with the State's Dissolved Oxygen requirements. This information would greatly assist the ERC in its assessment of what recommendations should be made. Other public information has been utilized and summarized in the background section and integrated in the remaining sections of this Brief, as germane.

(2) The critical legal concepts available to better assure the citizens of the Yadkin River Basin that they have reasonable expectations of a clean water supply and a healthy, restored environment in the future.

(3) The principles and objectives that should govern the shaping of the recommendations that the ERC will make to the Legislature.

(4) Putting It All Together in the Public Interest

With access to accurate information and an informed sense of the law, the ERC will have the tools necessary to assess what action the State might take: (1) to mitigate past harms; and (2) to plan with some confidence for the future of its citizens and businesses, without the constraints imposed upon the use of the Yadkin River flows in the past. Finally, Stanly County notes that the study produced by the ERC will not duplicate work done by the Federal Energy Regulatory

Commission, the federal licensing agency, since for the reasons explained below and to date, the FERC staff itself has declined to undertake or to require Alcoa to produce studies relating to the socioeconomic issues and matters of state-wide concern that are the subject of SB 1046's charge to the ERC.

I. BACKGROUND AND HISTORY OF THE YADKIN PROJECT

At the end of the 19th century and during the first decades of the 20th century, rivers and waterfalls across the United States increasingly became coveted property. The introduction of electric motors and lighting spurred endeavors nationwide to construct electricity generation facilities and by the early 1900s, hydroelectric power accounted for over 40% of America's supply.[1] In the late 1890s, Egbert B.C. Hambley, an English-born mining engineer living in Salisbury, N.C., recognized the great potential of the area surrounding the Yadkin Narrows as a site for a hydroelectric power plant. He helped put together a group of financiers led by Pittsburgh investment banker George Whitney.[2] In 1899, the syndicate purchased the Narrows of the Yadkin and began construction of a stone masonry dam in 1901, about four miles up the river from the mouth of the Narrows.[3] The Whitney Company failed in 1907 and the dam was never finished.[4]

In 1912, the French company L'Aluminium Français purchased the holdings of the Whitney Company and began construction of a major project in the mouth of the Narrows. The

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[1] U.S. Dep't of the Interior, Bureau of Reclamation website, http://www.usbr.gov/power/edu/history.html

[2] Irwin Speizer, "Aluminum Foiled." *Business, North Carolina.* (Nov 01, 2002).

[3] New York Times, "North Carolina River Power. New York and Philadelphia Capitalists to Invest in Big Plants." (Feb. 6, 1899).

[4] Joffre Lanning Coe, The Formative Cultures of the Carolina Piedmont 16, 18, *Transactions of the American Philosophical Society, New Series*, Vol. 54, No. 5, (1964).

onset of World War I, however, led to the return of the French workers as both they and funding were needed in Europe, leading to a halt in the construction in 1914. *Id.* at 18. The next year, the Aluminum Company of America purchased the entire French holdings, "redesigned the dam and power plants and began work on a grand scale." *Id.* Alcoa completed the construction of the smelting plant at Badin and began producing aluminum there in 1916. It concurrently finished the construction of the Narrows development, achieving dam closure and beginning operations in mid-1917.[5] Alcoa transferred its holdings to its wholly owned subsidiary, the Tallassee Power Company.[6] Tallassee eventually was renamed the Carolina Aluminum Company, the entity that filed for the original license of Project No. 2197 in 1958.[7]

A key dimension of Alcoa's early business plan was the acquisition of sites like the one on the Yadkin River. The Company was established in 1888 in order to exploit the patent for the aluminum smelting process developed by one of its founders. This process was (and is) very energy-intensive, requiring a great deal of electricity to convert bauxite ore into alumina and, finally, aluminum.[8] Alcoa's leadership openly expressed a desire to maintain a monopoly in aluminum smelting, as recorded in its Board minutes in 1896.[9] To further this end, they bought up sites for hydroelectricity generation that were then very cheap, capitalizing on the fact that they faced little real competition at the time.

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[5] Alcoa License App., Ex. C, at C-1.

[6] Id.

[7] 19 F.P.C. 704 (1958).

[8] David I. Rosenbaum, Market Dominance: How Firms Gain, Hold, or Lose It and the Impact on Economic Performance 56 (1998).

[9] Bradford L. Barham , *et al.*, Sunk Costs and the Natural Resource Extraction Sector: Analytical Models and Historical Examples of Hysteresis and Strategic Behavior in the Americas 442. *Land Economics*, Vol. 74, No. 4, (Nov., 1998).

Alcoa's domestic aluminum production soared with each of the World Wars, as military needs buoyed demand.[10] During these times, the Badin plant, like most all of Alcoa's smelting operations, was very profitable. From 1939 to 1943, Alcoa expanded its production many times over, routinely accounting for more than 90% percent of American output.[11] In 1945, the Company was found to be in violation of the Sherman Antitrust Act[12] and the government's efforts finally contributed to the end of the Company's monopoly; it sold excess, war-time facilities to two of Alcoa's competitors.[13] Thereafter, Alcoa nonetheless headed an oligopoly strong enough to set market prices.[14]

The Carolina Aluminum Company, Alcoa's subsidiary, filed an application for a license under the Federal Power Act on February 6, 1956. The application was for the existing developments at High Rock, Narrows, and the Falls, plus a then-proposed development at Tuckertown. On May 19, 1958 the Federal Power Commission, precursor to the Federal Energy Regulatory Commission, issued a fifty-year license for these four developments, effective from May 1, 1958.[15] At the time, the Badin plant employed nearly a thousand workers, hundreds of whom had served the Company loyally for decades.[16] The licensing order noted the Company's

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[10] John E. Lopatka and Paul E. Godek, Another Look at Alcoa: Raising Rivals' Costs Does Not Improve the View *Journal of Law and Economics*, Vol. 35, No. 2, at 312 (Oct., 1992).

[11] Rosenbaum, 62.

[12] United States v. Aluminum Co. of America, 148 F.2d 416 (2nd Cir. 1945).

[13] Stanley S. Reynolds, Strategic Capital Investment in the American Aluminum Industry 229, *The Journal of Industrial Economics*, Vol. 34, No. 3, (Mar., 1986).

[14] Rosenbaum, 63.

[15] 19 F.P.C. 704 (1958).

[16] *Id.* at 716.

professed concern over the economic impact on Stanly County of the loss of these jobs, and its argument that a federal license should issue for an expanded project in order to provide cheap power to support continued industrial operations.[17] Today Alcoa employs 31 people in the County.[18]

The successor of the Carolina Aluminum Company was Yadkin, Inc., a wholly owned subsidiary of Alcoa that operated the Project from the early sixties until the turn of this century. At the end of 1999, five power subsidiaries of Alcoa merged and became Alcoa Power Generating, Inc., to which the Yadkin license was then transferred.[19] Alcoa filed an Application for a Major New License for its Yadkin hydroelectric project with FERC on April 25, 2006.[20] Alcoa's primary purpose in the renewal of its license is to generate electricity for sale in the interstate electricity market, since it no longer uses the electricity in its industrial operations, which have been terminated. As part of the FERC relicensing process, numerous water quality issues at the Yadkin Project are being addressed. Although the North Carolina Division of Water Quality initially issued a Section 401 water quality certificate in November 2007, it subsequently withdrew that issuance in April 2008 because the conditions surrounding the certification had changed.[21] Presently, Alcoa has re-filed a request for Section 401 certification and the County has submitted a report on its water quality concerns to the DWQ. **Exhib. A.**

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[17] Id.

[18] Alcoa website, http://www.alcoa.com/yadkin/en/info_page/facts_on_relicensing.asp

[19] Notice of Merger of APGI (Jan. 28, 2000), *available at* eLibrary Accession No.20000203-0009.

[20] APGI License Application, FERC Project No. 2197-073 (Apr. 25, 2006).

[21] Letter from John Dorney, DWQ, to William Bunker, APGI (Apr. 16, 2008)(regarding Yadkin Hydroelectric Project), available at eLibrary Accession No. 20080425-5052.

II. STATUS OF THE FERC'S YADKIN RELICENSING PROCESS

The current FERC relicensing process is the first since the Yadkin Project was originally licensed in 1958 by FERC's predecessor agency, the Federal Power Commission. The formal federal licensing process began in April 2006, when Alcoa filed its application for a new license for the Yadkin Project. In May-June 2006, FERC issued a notice that the application had been filed, solicited additional study requests, and established a procedural schedule for the relicensing. 71 Fed. Reg. 28,679 (May 17, 2006); 71 Fed. Reg. 34,902 (June 16, 2006). On December 21, 2006, FERC issued a notice that it intended to prepare an Environmental Impact Statement for the relicensing. 71 Fed. Reg. 78,424 (Dec. 29, 2006). The Notice announced a Site Visit and FERC Scoping Meetings to be held in the vicinity of the Project in late January 2007; and it solicited Scoping Comments from interested stakeholders by February 2007. *Id.* FERC Staff also issued a Scoping Document 1 (SD1) that provided an initial list of the issues that FERC Staff believed would be relevant to the relicensing proceeding.

One week later, on December 28, 2006, FERC issued a notice that it had accepted the Alcoa License Application for filing, and it solicited motions to intervene and protests. 72 Fed. Reg. 779 (Jan. 8, 2007).

Stanly County and many local residents attended the Scoping Meetings in January 2007, and provided oral and written comments regarding the Alcoa License Application proposal. Their concerns included, among other things, Alcoa's failure to provide socioeconomic benefits to the local community and the State, resulting from Alcoa's proposal to no longer use the Project's low-cost power to support North Carolina economic development; Alcoa's failure to commit to use Project revenues to mitigate local environmental damage that had been caused by the aluminum manufacturing activities made possible by the Yadkin Project; and Alcoa's failure

to study and mitigate any local groundwater and surface water contamination caused by Alcoa's industrial activities in Stanly County. January 24, 2007, 1:00 p.m. Scoping Meeting Tr., *available at* FERC eLibrary Accession No. 20070124-4036; January 24, 2007, 7:00 p.m. Scoping Meeting Tr., *available at* FERC eLibrary Accession No. 20070124-4035.

On March 13, 2007, FERC Staff issued a Notice that Alcoa's License Application was Ready for Environmental Analysis, and it solicited comments, recommendations, proposed terms and conditions, and prescriptions within 60 days. 72 Fed. Reg. 12,791 (Mar. 19, 2007). On May 4, 2007, ten days before responses to the Notice of Ready for Environmental Analysis were due, FERC Staff also issued Scoping Document 2, which rejected many of the issues previously raised by Stanly County and local stakeholders on the grounds that Alcoa, Inc., is a distinct corporate entity from APGI, the wholly-owned Alcoa, Inc. subsidiary that holds the Yadkin Project license (Scoping Document 2, at 14, *available at* FERC eLibrary Accession No. 20070504-3006); and that environmental contamination and other concerns regarding land located outside the FERC Project boundary were beyond the scope of the FERC's licensing analysis. *Id.* FERC stated that it would address the socioeconomic issues raised by Stanly County and local residents in its analysis of the Project. *Id.* at 20-21.

While FERC was processing the Alcoa License Application, Alcoa was conducting a parallel settlement negotiation process in an effort to obtain state, agency, and stakeholder agreement to a comprehensive relicensing settlement agreement and to avoid a contested licensing proceeding. While the settlement and consultation process is a favored form of procedure at FERC, it has its limitations. Some local participants felt that they were not given real choices, and were required to attend long meetings without adequate explanations. When issues of concern to them were raised, there was no way to effectively challenge a denial by

Alcoa or the consultants of the need for a study on, say, the socio-economic effects of contaminated wells in the County, that might be the result of the industrial process that was supported by the Project's hydro operations. As one participant in the negotiation process later remarked:

> Imagine a bunch of people like me: nonprofit administrators, some fish biologists, and county employees and a few lake home owners. We're sitting in a room facing a team of Alcoa Corporate lawyers. Can you imagine what that would be like?
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> We were told that there would be no discussion of the economic issues - only environmental issues, and only environmental issues pertaining to the lakes - not the smelting plant. So we spent years sitting around a table with Alcoa lawyers discussing lake levels, dissolved oxygen and fish life cycles. Never a word about the value of the hydroelectric production. Never a word about jobs. Never a word about economic remuneration for the kilowatts. Mostly because we were too naive to insist. The length of the license - 50 years - was not up for discussion. They controlled the agenda and the discussion and the resettlement agreement. We were handed it and told to sign it and that was that.
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> The ridiculous thing ... was that we were sitting there in the first place. The people who should have been sitting there included (among others) him or the Secretary of Commerce. Or the Secretary of DENR. Or the Governor's Chief of Staff. Commerce at least has the experience of negotiating with corporations all the time - incentives for jobs. There was never anyone at the table with the experience necessary to really negotiate with them. Admittedly in hindsight, how incredibly silly that the state allowed me and a bunch of fish biologists to negotiate an agreement worth multimillions to the state.[22]

Alcoa filed its proposed Relicensing Settlement Agreement ("RSA") on May 7, 2007. The RSA was executed by some, but not all, stakeholders who were involved in the licensing process. Stanly County, which had earlier objected to the failure of draft settlement agreements

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[22] Quote from Nancy Gottovi.

to address its concerns, was excluded from the RSA negotiations after it expressed its objections and was not a party to the RSA.

On September 28, 2008, FERC Staff issued its Draft EIS for the Yadkin Project that recommended issuance of a new Yadkin license consistent with the RSA, with only very limited modifications. The Yadkin Project socioeconomic analysis provided in the Draft EIS was essentially limited to the economic effects of recreation/tourism visits to Project reservoirs and to price effects on local home values. There was no analysis of the alternative proposed by Stanly County, which would have required Alcoa to commit a certain share of Project's electric output for cost-based sales to support local economic development. FERC Staff conducted public meetings and solicited comments on the Draft EIS; and on April 18, 2008, Staff issued a Final EIS.

Although FERC is heavily influenced by its Staff's recommendations, FERC itself has not yet issued any ruling on the merits of Alcoa's license application for the Yadkin Project, or the comments and recommendations submitted in the relicensing proceeding. The recent issuance of the Final EIS completed the FERC project analysis required before a license can be issued. FERC, however, is presumably awaiting the completion of the State of North Carolina's Clean Water Act Section 401 Water Quality Certification process before issuing a license for the Project. This certificate is required prior to FERC's issuance of a license. Until FERC rules, the record in the Yadkin relicensing proceeding remains open.

III. THE FEDERAL POWER ACT

A. The Basic Federal Licensing Framework

Part I of the Federal Power Act ("FPA") established a federal licensing regimen for the development of the hydroelectric power potential of the waters of the United States. Generally speaking, the concepts involve a time-limited federal license, conditioned to protect the public. Accordingly, with limited exemptions, entities that seek to develop hydroelectric facilities on the nation's waterways must first apply for and receive a license from the Federal Energy Regulatory Commission ("FERC"). Licenses are not permanent; the FPA expressly provides that their term cannot exceed 50 years. FPA § 6, 16 U.S.C. § 799. While in force, however, the federal license is paramount in declaring how the waters are to be governed. *See, e.g., First Iowa Hydro Electric Coop. v. FPC*, 328 U.S. 152, 167-68, 181 (1946); *Cal. v. FERC*, 495 U.S. 490 (1990); *Sayles Hydro Assocs. v. Maughan*, 985 F.2d 451, 456 (9th Cir. 1993) (holding that the FPA occupied the field of hydropower licensing, except to the extent that proprietary water rights are at issue).

In adopting the licensing requirement, Congress declared that the navigable waters of the United States belong to the public, not to any private interest. This principle pre-dates even the 1920 enactment of Part I of the FPA (then known as the Federal Water Power Act). In 1908, President Theodore Roosevelt, vetoing a bill that would have granted a perpetual hydropower license for the Rainy River Project, stated:

> The public must retain the control of the great waterways. It is essential that any permit to obstruct them for reasons and on conditions that seem good at the moment should be subject to revision when changed conditions demand. The right reserved by Congress to alter, amend, or repeal is based on this principle: but actual experience of what happens with indeterminate public-

> utility franchises proves that they are in the vast majority of cases practically perpetual. Each right should be issued to expire on a specified day without further legislative, administrative, or judicial action.
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> . . . .
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> Provision should be made for the termination of the grant or privilege at a definite time, leaving to future generations the power or authority to renew or extend the concession in accordance with the conditions which may prevail at that time.

H.R. Rep. No. 99-507, at 11-12 (1986), as reprinted in 1986 U.S.C.C.A.N. 2496, 2498.

More recently, when the last major revisions were made to the hydropower licensing provisions of the FPA in 1986, President Roosevelt's veto language was quoted approvingly and its themes were repeatedly referred to by a House Committee on Energy and Commerce report dealing with legislation that ultimately became part of the Electric Consumers Protection Act of 1986. House Report No. 99-507 reporting out H.R. 44, which eventually became the Electric Consumers Protection Act of 1986, stated:

> Like Roosevelt and the Congress in 1920, our purpose is not to perpetuate a license in the hands of any utility, but to provide that each utility compete in a process of striving for improvements under rigorous tests administered fairly and effectively by FERC that will better serve the Nation and consumers and, if they fail those tests, to provide for a license transfer to one better qualified.

Id. at 14-15, 1986 U.S.C.C.A.N. at 2501. In defining what it meant by "rigorous," the Committee stated that "if no competition existed, the Committee approach ensures that an existing licensee will not be 'rubber stamped,' but must again prove that its project qualifies as 'best adapted' on power and non-power grounds." *Id.* at 15, 1986 U.S.C.C.A.N. at 2502.

B. Achieving the Public Interest through License Conditions

FERC must also require conditions *at the time of licensing* to address environmental and other non-power factors. In the legislative history of the Electric Consumers Protection Act of 1986, Congress expressed dissatisfaction with the technique used in licensing to defer the resolution of issues until *after* licensing, when intervention was difficult because of both the Commission's rules and the inability of citizens to follow up on the details of deferred activities. Citing the court's disapproval in *Yakima Indian Nation*,[23] of FERC's deferral of fishery protection issues until *after* licensing, the House Committee noted that "FERC's treatment under the Federal Power Act and applicable environmental laws of energy conservation, fish and wildlife, recreation, and other non-power factors has been less than satisfactory." *Id.* at 17, 1986 U.S.C.C.A.N. at 2504.

C. Relicensing Is Somewhat Different from Initial Licensing

Section 15 of the FPA provides the basis for relicensing of existing, licensed hydro projects and specifically requires consideration of the effect of issuing a "new" license (which is actually a renewal license) on the local community:

> [The Commission shall consider] [t]he need of the applicant over the short and long term for the electricity generated by the project or projects to serve its customers, including, among other relevant considerations..., the effect on communities served or to be served by the project, and in the case of an applicant using power for the applicant's own industrial facility and related operations, the effect on the operation and efficiency of such facility or related operations, its workers, and the related community.

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[23] 746 F.2d 466 (9th Cir. 1984).

16 U.S.C. § 808(a)(2)(D). The licensee's history is also relevant in the relicensing context: "In the case of an application by the existing licensee, the Commission shall... take into consideration... [t]he actions taken by the existing licensee related to the project which affect the public." *Id.* at (a)(3). In other words, the statute expands the scope of considerations at relicensing time. This makes sense, because in most instances, after the initial licensing term, the investment in the Project has generally been paid off, and the FERC has had the opportunity to observe whether the Licensee has proved to be a good steward of the public's resources.

IV. MORE ON RELICENSING LAW: THE FEDERAL "RECAPTURE" PROVISION AND THE PUBLIC INTEREST

A. The General Concept

At the end of a FERC hydropower license term, the Federal Power Act and FERC's regulations provide for various outcomes: (1) relicensing to the existing licensee; (2) relicensing to a competing license applicant; (3) surrender of the license by the existing licensee; or (4) federal takeover of the Project. Section 7(c) of the Federal Power Act, 16 U.S.C. § 800(c), provides:

> Whenever after notice and opportunity for hearing, the Commission [referring to the Federal Energy Regulatory Commission or FERC] determines that the United States should exercise its right upon or after the expiration of any license to take over any project or projects for public purposes, the Commission shall not issue a new license to the original licensee or to a new licensee but shall submit its recommendation to Congress together with such information as it may consider appropriate."

See **Exh. B.**

The concept here is not unusual if one begins with the fundamental concept embedded in the Federal Power Act, namely, the flowing waters belong to the people. Congress knew that many things might have changed by the time a 50-year license expired, including the best use of

the flowing waters of the Nation. Accordingly, it reserved to the federal government the right to take back the Nation's rights in the flowing waters in order to best serve the statutory goals of the Federal Power Act, including the public interest.

Thus, at relicensing time, if FERC determines, based on the hearing record, that federal recapture is in the public interest, it can recommend to Congress that the federal recapture right expressly included in the FPA be used. 18 C.F.R. §16.15 (2008). In that instance, because Alcoa is not a municipality or state agency, the FPA establishes the transfer price as: (1) net investment, but not to exceed fair market value; and (2) severance damages.[24] FPA § 14, 16 U.S.C. § 807. "Net investment" is defined as the original cost less depreciation, as established by the Commission's accounting regulations. FPA § 3(13), 16 U.S.C. § 796(13). "Severance damages" are the reasonable damages to the property caused by the loss of the Project by the previous owner, where some of the electrical properties have been excluded from the government takeover. For example, if the U.S. Government does not wish to include a portion of the Project transmission line in its recaptured project, the remaining line may be stranded and useless to the previous owner. That would probably be included in a consideration of severance damages, if the owner could not otherwise find value in the now abandoned line. Although it has been argued, severance damages are not considered to include lost profits forever by the losing entity. *See, e.g., Escondido Mut. Water Co.*, Op. No. 36-A, 9 F.E.R.C. ¶ 61,241, 61,509 (1979), *rev'd on other grounds*, 692 F.2d 1223 (9th Cir. 1982), *aff'd in part and rev'd in part*, 466 U.S. 765 (1984). ("When the remaining electrical properties are as useful after the taking as before,

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[24] In the case of municipal and state agencies, the transfer price is fair market value.

no severance damages are required. Where all the properties of a license are taken there can be no severance damages.").

Here, the Yadkin Project's net investment price is currently considerably lower than Alcoa's claimed value for the Project,[25] and the severance damages are not likely to be significant, since they are premised on Project facilities that are not recaptured and rendered useless to the former licensee if a transfer occurs. The recapture provision (FPA § 14, 16 U.S.C. § 807) should not be confused with another provision of the Federal Power Act, (Section 21, 16 U.S.C. § 814) which expressly provides for the exercise of eminent domain at fair market value during the term of the license. The purpose of the statute was to provide a fair and reasonable transfer price upon the expiration of the license, in order not to block a transfer to a new owner that would operate the Project in a way that was, in the FERC's judgment, better adapted and in the public interest. As a practical and legal matter, there should be no doubt that the reversion of the federal government's water rights at the expiration of a license does not constitute a "taking" of property rights inasmuch as the law expressly provides for such transfer upon expiration of the limited license and because every licensee acknowledges this right in the Government and must consent to it prior to accepting any federal hydroelectric license. This is illustrated by reference to the specific case of Alcoa and its Yadkin Project, which is discussed in the next section.

B. Alcoa and the Recapture Provision

Although Section 14's recapture procedures have not previously been used, they have been part of the Federal Power Act since its inception. Alcoa has long been familiar with the

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[25] According to Alcoa, the Yadkin net investment was approximately $24-million at the end of 2005. APGI License Application, Exh. C at D.2.2 (April 2006). In contrast, Alcoa claimed that the fair market value of the Project was $130-million. *Id.* at D.2.1. Use of market valuation techniques would lead to even higher values.

provision. The federal license it accepted for the Yadkin Project in 1958 includes provisions that are specifically intended to facilitate the implementation of the recapture process;[26] and Alcoa submitted comments on recapture during the 1967-1968 legislative session. See *United States Relicensing or Recapture of Licensed Hydroelectric Project, Hearings before the Committee on Commerce, U.S. Senate*, 90th Cong., 2d Sess., on S. 2445, February 26 and 27, 1968, Serial No. 90-62, pp. 146-148. In its April 2006 application for a new Yadkin Project license, Alcoa expressly acknowledged FPA § 14 and the net investment transfer price it establishes:

> D.2 Estimated Takeover Costs as per Section 14 of the Federal Power Act
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> Section 14 of the Federal Power Act (FPA) reserves to the United States the right to take over a non-publicly owned project upon expiration of its license. In the event that such take over is ordered by the Federal Energy Regulatory Commission (FERC), Alcoa Power Generating Inc. (APGI) would, pursuant to Section 14, be entitled to be reimbursed for its "net investment", not to exceed "fair value," plus any "severance damages" suffered (see 16 U.S.C. § 807). At the time of the filing of this License Application, there was no indication that any federal department or agency, state or municipality has or will recommend takeover or redevelopment of the Project. Nonetheless, APGI hereby submits the basic information required by FERC's regulations that would be needed to quantify the compensation to be paid to APGI pursuant to Section 14.

Alcoa License Application, **Exh. C**. Table D.2-2 of Alcoa's Yadkin License Application states that Alcoa's net investment, as of 2005, was about $24.2 million.

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[26] *See* Article 15 of the recently expired Yadkin Project license (describing the amortization reserves and net investment calculation which are used to calculate the federal takeover price under FPA Section 14), and Article 17 (stating that "In the event the project is taken over by the United States upon the termination of the license, as provided in Section 14 of the Act, or is transferred to a new licensee under the provisions of Section 15 of the Act ..."). In addition, Article 18 states that the terms and conditions set forth in the license shall not be construed as impairing any terms and conditions of the Federal Power Act. As discussed above, Section 7 (c) of the FPA expressly provides for the FERC to recommend takeover if the record in the relicensing case supports such a recommendation; and Section 14 establishes the compensation payment in the event of takeover.

Federal recapture of FERC-licensed hydropower projects, at a statutorily defined transfer price based on net investment, is neither radical nor a recent invention. As the incumbent licensee for the Yadkin Project, Alcoa has already received from the federal government—free of charge—the exclusive right to use the public's water for hydropower generation and private profit for over fifty years. Alcoa's licensee status also gave Alcoa the federal power of eminent domain to acquire any property necessary to develop the Yadkin Project. FPA § 216(e), 16 U.S.C. § 824p(e). Alcoa used this condemnation power to obtain property related to the Yadkin Project. In addition, Alcoa has benefitted from the headwater benefits provision of the FPA, which requires that downstream beneficiaries compensate Alcoa for headwater benefits received.

In voluntarily accepting the valuable federal grant of a hydropower license for the Yadkin Project, Alcoa agreed to the terms of the Federal Power Act, which expressly provide for federal recapture at the end of the license term for net investment—a price that fully compensates Alcoa for the money it spent in developing the Project. Having enjoyed the enormous financial benefits of a federal hydropower license to use the public waters for over fifty years, and used the federal government's power of eminent domain to its own advantage, Alcoa should not be heard to argue that it should be allowed to break a contract it entered into with the Federal Government, to return the Government's right to control the flows of water for power, and takeover the related power facilities, at the end of the license period if it were determined that a better use might be made of the project.

V. HOW WOULD A RECAPTURE OPTION WORK IN THE YADKIN CASE?

As discussed above, recapture under the Federal Power Act is a right of the United States. FPA § 14, 16 U.S.C. § 807. That the federal recapture right has not been exercised to date demonstrates how powerful the interests are that influence events in Washington, D.C.

However, Congress has, to date, held the line and the law remains on the books, waiting for someone to use it. This section describes, given the current status of the Yadkin Project relicensing case, just how the provisions of the law could work if the State determined that recapture was the most likely to lead to the necessary State control of the Yadkin River flows.

Although the State of North Carolina cannot unilaterally require a federal recapture of the Yadkin Project, the State can recommend in the current relicensing proceeding that FERC, on its own motion, institute a process in which it recommends that Congress exercise its federal right with respect to the Yadkin Project. To support such a position, the State of North Carolina would need to promptly present evidence in the present relicensing proceeding demonstrating that the public interest requires the State's ownership and control of the Yadkin River flows. One helpful piece of evidence might be a contract in which the State demonstrates its willingness to pay the net investment amount to compensate the United States for exercising its rights in the takeover option agreed to by Alcoa in its 1958 license. The State's agreement would be with the U.S. Government and provide for the State to pay the transfer price for the Yadkin Project, and in exchange, to be the recipient of the Project license upon successful legislation approving the agreement. In this instance, FERC would have the authority to issue a conditional license to Alcoa, subject to final Congressional action on the Federal Government's exercise of its authority, and a finding that it has determined that such action is in the public interest. In the two-year interim until Congress acts, FERC can issue a conditional license, enabling the existing Licensee to continue to operate the Project subject to final action by Congress.

In light of FERC's consistent record in failing to recommend Section 14 recapture, it appears that the key to implementation of any recapture approach is to provide FERC, during the course of the relicensing proceeding, with ample *evidence* setting forth a state position favoring

recapture. In the current Yadkin relicensing proceeding at FERC, the participating North Carolina agencies agreed to sign off on an Alcoa-proposed settlement agreement that leaves the Yadkin Project in the hands of Alcoa, primarily for power production and sales purposes. These agencies have traditionally and generally been concerned about implementation of recreation, fish and wildlife, and dissolved oxygen standards. Officially, the record is still open, but what has been missing has been a comprehensive North Carolina, state-wide approach, encompassing a broad set of considerations.

The current unusual drought conditions in the Southeast underscore the need to re-think how our rivers influence the State's well-being and provide incentives for the State to take advantage of the laws that now exist, including whether the State should seek a greater say in how the flows of the Yadkin River will be used now and in the future. Presently, the use of the flows in the Yadkin River have been determined, for all practical purposes, by the Alcoa Settlement Agreement. In other words, Alcoa has determined what is acceptable to it, in terms of making money. Whether that standard coincides with the State's broader interests for the next fifty years is what the ERC needs to determine.

Any State evidence supporting recapture by the federal government on behalf of the State should be submitted to FERC soon. Although the final decision in the pending State Clean Water Act Section 401 Water Quality Certificate proceeding has been delayed until the completion of the ERC's report, there is little to halt the issuance of a new FERC license for the Yadkin Project, once the ERC issues its report and the 401 certificate is issued by DWQ. Currently, FERC itself has not yet officially decided whether recapture would be appropriate for the Yadkin Project. However, the agency's analysis of the Project is well-advanced, and the FERC technical Staff's recent Final Environmental Impact Statement for the Yadkin Project

includes routinely-used boilerplate language stating that the Staff does not consider federal takeover to be reasonable alternative because Congressional approval would be required, no federal agency has sought recapture, and no federal agency has shown an interest in operating the Project.[27]

Beyond the routine mantra found in all relicensing proceedings, FERC does not really explore the federal recapture option. The Yadkin relicensing proceeding is no exception. Stanly County has presented real evidence as to why business as usual is not in the public interest, including issues of socio-economic concern, environmental contamination, public health issues, and direct impacts on the community that should be remedied in this relicensing process. Stanly County has requested that these considerations be reflected in license conditions to the new license, if issued to Alcoa. They include mitigation funds to clean up the contamination left by Alcoa's 90-plus years of conducting business as well as a fund to assist economic development in Stanly County. These are all issues that Congress requires FERC to consider in making its public interest determination. [**Exh. D** (Stanly County License Terms and Conditions)]

The fact is that FERC's relicensing decisions invariably ignore these socio-economic issues. FERC has told Stanly County that it should do its own studies in this regard and has refused to require Alcoa to produce the studies that could provide the kind of evidence necessary to document the mitigation needed in the County, commensurate with the 50-year benefits that Alcoa seeks to continue from using the Yadkin River flows. For the most part, FERC's "analysis" of the public interest amounts to a cost- benefit analysis of whether the Licensee should be required to provide a bit more recreation, improve the water quality and fish passage

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[27] Office of Energy Projects, FERC, *Final Environmental Impact Statement for Hydropower Licenses,* FERC/FEIS-0215F (2008) at 35, *available at* eLibrary Accession No. 20080418-4000.

somewhat, and possibly some modest economic benefits, provided they do not, in FERC Staff's opinion, jeopardize the Licensee's view of acceptable profits. Furthermore, in the FERC's Yadkin relicensing record, there is no evidence of the profits gained by Alcoa over the past 50 years as a result of its ownership of the Yadkin Project, or what Alcoa estimates it will earn in the future from sales of Yadkin Project electricity. None of this Project-specific information is available to the public although it is important to the evaluation by the ERC and should be of importance to the FERC.

Summary of Federal Recapture Option

- The State of North Carolina would seek to participate as a party in the FERC relicensing proceeding for the Yadkin Project, and request permission to augment the official record with the ERC report and recommendations and any other pertinent studies, information and recommendations. It would then request FERC to recommend to Congress that it exercise the recapture provision in the FPA to purchase the Yadkin Hydroelectric Project on behalf of the State of North Carolina, as being in the public interest and subject to payment by the State of the net investment of the Project and any severance damages found reasonable by the Commission. Alcoa would receive a conditional license and continue to operate the Project until Congress acted.

- The State would provide FERC with a draft agreement with the United States, as the Federal law requires a payment to Alcoa equal to its net investment which would be approximately $25 million.

- In that draft agreement, the State would agree in exchange, to reimburse the federal government for the purchase price and assume the ownership and control of the Yadkin Project and the license, for the benefit of the people of North Carolina. Once FERC transmits its recommendation to Congress, Congress has two years to pass special legislation enabling the recapture of Yadkin to the US Government and the transfer of the Yadkin Project and its license to the State of North Carolina, subject to payment per an agreement.

- Ownership and being a Licensee of the Project would enable the State to better control the flows of the Yadkin River in the interest of the public and the citizens of North Carolina. Without this status, the State would be a supplicant and reduced to asking Alcoa's permission to change the Project's operating conditions and the flows in the Yadkin River; furthermore, Alcoa is entitled to demand that the State guarantee Alcoa's profits if the State's changes might result in a loss of income to Alcoa.

VI. ARE THERE REASONS SUPPORTING THE USE OF THE RECAPTURE OPTION IN THE CASE OF THE YADKIN PROJECT?

The recapture option is unusual but perhaps the only way that the State of North Carolina can assure its citizens that the State can act promptly and in their best interest in planning for the future. The reasons supporting this conclusion are as follows:

- The Yadkin River is a major source of present and future fresh water for drinking supplies, recreation, industrial uses, including cooling water for electric generation facilities in the State, and the underpinning for a high standard of environmental quality within the State.

- If the State does not take the opportunity now, the next chance is 2058.

- If the State owned and operated the Yadkin Project, it becomes a major player in assuring the use of the River for the public interest. Otherwise, the State ceases to be a major influence in the Yadkin Project after relicensing is done, because the terms of use prescribed in the new license are tantamount to a contract between the Licensee and the United States government, and the terms of that contract cannot be altered without *mutual consent* during the term of the license.

- Alcoa has yet to complete the cleanup of ninety years of smelting operations that have left Stanly County with hazardous wastes and an unknown amount of future public health concerns. Alcoa can sell the Yadkin Project and its license to any third party, with no certainty that the clean up of these wastes will occur and with little control by the State over the pace of clean up. Ownership of a resource that generates tens of millions of dollars per year would enable the State to expedite the cleanup and better assist the affected counties to provide both economically and socially for their citizens.

- The major economic product of the Yadkin Project is electricity. Alcoa, the licensee, has no commitment to sell the power from the Project *at cost* to electricity consumers in North Carolina, even though the Yadkin River belongs to the people of the State of North Carolina.

It is reasonable to ask whether the State can afford to take action supporting recapture, and ultimately, this decision depends on the Committee's obtaining adequate information, about the following:

- Although Alcoa has not provided its revenue projections for the Yadkin Project, Project revenues are likely to significantly exceed costs. Presently,

the Yadkin Hydroelectric Project produces at least $40 million in gross annual revenues, with annual costs of only about $2.5 million. New enhancements under the relicensing may add another $1.5 million annually to that cost, with a one-time cost of approximately $4 million, leaving a substantial profit to the holder of a new fifty-year Project License. Major maintenance that Alcoa has deferred would also need to be completed after any federal recapture, in order to bring the dissolved oxygen from the Project flows into compliance with state standards. While those costs are significant, the value of the Project's electric output would substantially exceed costs under even very conservative energy price assumptions.

- Ownership by the State is a preferable alternative to the current Relicensing Settlement Agreement that only yields about $1.5 million in additional annual benefits to the stakeholders in North Carolina. Stanly County does not know what the actual or true costs of the Relicensing Settlement Agreement are to Alcoa, in terms of its tax benefits and net costs as this information is held closely by the corporation. Nevertheless, if asked by the ERC, Alcoa should be willing to provide this information.

The choice for North Carolina is between either a combination of continued exploitation and neglect of the contaminated areas in Stanly County or, in contrast, an enlightened management by the State in the interest of the people of the region and the State. It is a choice worth considering.

VII. ITEMS FOR ERC CONSIDERATION

A. The Socioeconomic Impacts of Alcoa's Decision to Discontinue Its Manufacturing Operations at Badin after Developing the Yadkin Hydroelectric Project for its Low-Cost

The crux of this issue is that Alcoa's decision to move all of its manufacturing jobs out of Stanly County and the State has wrought substantial adverse socioeconomic, impacts that have not been mitigated by Alcoa. Nevertheless, Alcoa wants to continue to utilize the public waters of the Yadkin River in North Carolina for its sole corporate economic gain, by renewing its federal license for the Yadkin Project. By reserving the exclusive right to control the flows of

the Yadkin River to itself, it necessarily removes that right from the State, which can no longer anticipate the nexus it has had with Alcoa over the past fifty years because of Alcoa' s corporate decision to leave the State.

At the time of the last Yadkin Project licensing in 1958, Alcoa supported the licensing of an existing, smaller hydro project and the construction of the Project's fourth dam on the grounds that the hydropower from the Yadkin was needed to support the new aluminum smelting facilities that would provide in excess of 900 jobs to residents of Stanly County and the adjoining counties. *Carolina Aluminum Co.*, 19 F.P.C. 704, 716 (1958). The Federal Power Commission ("FPC") order issuing that license made it clear that the importance of the project to the smelting operation, and therefore to the local economy, was a significant consideration in its decision to issue a 50-year license to Alcoa:

> The operations of the Badin plant of Aluminum are a useful contribution to the industrial life of the Yadkin Valley and their continuation is greatly in the public interest. It is apparent that assurance of this continuation depends upon the ability of [the applicant] to obtain a fifty-year license for the entire Yadkin Project (Project No. 2197).

Carolina Aluminum Co., 19 F.P.C. at 714, emphasis added. The FPC expressly found that the reconstruction of the Badin smelting works made possible by the new 1958 Project license would provide continued employment to more than 900 people in the Badin area:

> The Applicant Carolina Aluminum Company proposes to reconstruct its smelting plant at Badin to increase both its maximum capacity and its firm or continuous smelting capacity in order to increase the usefulness and efficiency of the said smelting plant, and such proposed reconstruction is expected to afford *continued employment to more than 900 persons in the Badin area.*

Id. at 722, emphasis added. According to the FPC, granting a new fifty-year license to the Project was justified, because otherwise, "continued operation of the Badin [smelting] works

would be threatened, to the detriment of its 977 employees (as of 1957) and the surrounding region." *Id.* at 705, n.1.

Over the past few years, however, Alcoa has shut down its smelting facility and eliminated almost all of these jobs. This has had a devastating economic impact on the region, which never had a surplus of jobs. Alcoa is now in the process of trying to relicense the hydroelectric project for another 50 years. But this time Alcoa will not be using any of the electricity generated by the Yadkin Project to create jobs for the people of North Carolina. Instead, Alcoa will use the public waters of the Yadkin River to generate electricity at an enormous profit to be sold to the highest bidder on the interstate electricity grid. The profits will be exported elsewhere. Unlike our homegrown regulated utilities, Alcoa answers to no one in the State of North Carolina.

B. Alcoa Took Advantage of a Tax Break Based on a False Promise and Reaped $1 Million Per Year From the State of North Carolina.

Alcoa received an energy tax exemption, on the grounds that Alcoa would retain around 400 jobs at the Badin facility. However, almost simultaneously with the passage of the tax break, Alcoa began eliminating those jobs but it kept all the dollars from the state-granted incentives even though it did not keep its end of the bargain.

Alcoa owes that money back to the State of North Carolina. The ERC should determine what portion of the energy tax abatement was earned by Alcoa and what portion was not. Any taxes due to the State should include a specific pass-through of some portion of the taxes directly to Stanly County for: (a) environmental remediation, and (b) economic development.

C. *Alcoa Has Advocated Linking Low-Cost Power to Local Job Creation in Other States. Why Not North Carolina?*

In 2007, the State of New York reached an agreement in principle with Alcoa which committed to maintain hundreds of jobs through the year 2043 in exchange for the State's continuation of its low-cost hydropower sales to Alcoa's Massena, New York aluminum manufacturing plants. Alcoa agreed to invest approximately $600 million for the major overhaul of its Massena East smelter and to retain approximately 1,065 jobs between its East and West Massena plants for at least 30 years.

Additionally, Alcoa will fund a $10 million "North Country Economic Development Fund," which would be jointly administered by the New York Power Authority and Empire State Development. It will be used exclusively for creating jobs and capital investments in the region, including the counties of St. Lawrence, Franklin, Essex, Jefferson, Lewis, Hamilton and Herkimer. The agreement also provides that:

* Alcoa maintain a total employment level of between 1065 and a minimum of 900 jobs over the term of a 30-year contract, which would go into effect July 1, 2013, when the current power contract is due to expire;

* for the first time, NYPA could share in Alcoa's profits when aluminum prices are high by linking electricity prices to the price of aluminum;

* NYPA may proportionately reduce the power allocation if employment levels fall below agreed to levels;

* Alcoa and NYPA may, under certain economic conditions, extend the contract for an additional ten years; and

* Alcoa has two years to complete an engineering study of the proposed rebuilding of the Massena East plant or the power contract would be void.

In Chelan County, Washington State, the citizens have the control of water power rights, through a FERC license. There, an agreement was finalized with Alcoa in July 2008, with terms

comparable to those sought by Stanly County and local stakeholders in the Alcoa Yadkin proceeding here in North Carolina. Alcoa agreed that its right to continue to benefit from low-cost hydroelectricity was contingent on using that electricity to provide local manufacturing jobs. **Are the people of Stanly County and North Carolina due any less consideration for their water resources than the citizens of the states of Washington, New York, South Carolina or Tennessee? It appears that the chief difference is that in those states, as opposed to North Carolina, the hydropower license is held by a State or local entity. Relicensing is a once-in-fifty-years opportunity for the State of North Carolina to obtain the same right to control the use of the public water resources that flow through the State.**

VIII. ASSURANCE OF AN ADEQUATE, CLEAN FUTURE WATER SUPPLY FOR THE REGION.

A. How Big Is the Contamination Problem?

It is obvious that burial of contaminated industrial waste can adversely affect not only the land, but also the waters in a region. It is axiomatic that clean water and land are essential factors if the County is to improve its economic situation. For Stanly County, however, the task is even larger. It has attempted to identify and relate its concerns in the relicensing process about its legacy of environmental contamination caused by Alcoa's operations in Badin, which will constitute Stanly County's future, with or without Alcoa's continuing presence in the aluminum smelting business. Known contaminants include cyanide, fluoride, PCBs, solvent, metals, hydrocarbons, benzene, naphthalene and methane. Stanly County has the highest ground water concentrations of arsenic in the State and there is reason to believe that these levels are in part due to the Badin operations of Alcoa. See **Exh. E.** In court documents from Washington State, Alcoa acknowledged that an environmental cleanup at Badin would cost **in excess of**

$50 million. See **Exh. F.** This calls into question Alcoa's statements that, after spending only $8 million in remediation and analysis at Badin, no further action is necessary. See **Exh. G.** Responses of Alcoa/APGI to Stanly County Questions, Question 2 (February 22, 2007).

The presence of such contamination raises several questions, including: (1) does the remaining contamination constitute a significant hazard to the community; (2) is the contamination spreading to other bodies of water, and (3) does the contamination inhibit new and desirable development in the Badin area, which needs new jobs to replace the lost aluminum manufacturing jobs and to recover its stable economic basis now that Alcoa's Badin smelting plant is essentially closed and has been partially dismantled.

Alcoa's industrial operations included the disposal of spent pot-linings and other refuse from the smelting operations which is now known to be hazardous. The Badin Smelter produced 4,800 tons per year of spent pot linings—a hazardous waste containing cyanide complexes. For decades, these pollutants were discharged into our air and disposed of on our lands and in waterways without regulation or concern. In public testimony at a FERC hearing held in Stanly County, both a local physician and a local mortician provided their opinions of the human costs, based on their experiences in Stanly County. [**Exh. H.** A full text of that hearing is provided as part of Stanly County's submission.]

Environmental contamination of the Badin Smelting Works site and the surrounding areas, located on the shore of Badin Lake, has been documented in ground water, swimming areas, soil and our streams and riverbeds. The County is also aware that certain Alcoa-owned lands in Stanly County were used in the past as disposal sites for post-processing industrial waste from the Badin Smelting Works. The County does not know the extent and location of all of

these sites, which may be contaminated with hazardous waste, or the extent of seepage into the River or its tributaries.

To assess the consequences of Alcoa's receipt of a new license, the ERC should request from Alcoa information as to the sites where it disposed of its industrial waste; its schedule for removing all the waste from Stanly County; and if it does not intend to remove all the waste within the next ten years, what its management is now estimating to be the timetable. Furthermore, it should require Alcoa to commission an independent study on the effects of the industrial operations on the health of individuals in the County over the period of its operations. How is this information germane to a FERC license? Let us explain.

B. The Law States that These Health Impacts to the Community Are Germane to the Relicensing Decision.

The relicensing statute provides that prior to renewing a license, a FERC license applicant needs to explain its "need ...over the short and long term for the electricity generated by the project...to serve its customers." FPA, Sec. 15(a)(2). That same section further requires FERC to consider "the effect on communities served or to be served by the project, and in the case of an applicant using power for the applicant's own industrial facility and related operations, the effect on the operation and efficiency of such facility or related operations, its workers, and the related community," in making its decision, whether or not there is a competing license application.

The pace of the clean-up has to be accelerated if Stanly County is going to be able to move forward economically to replace jobs and foster economic development. The FERC relicensing proceeding for Alcoa's Yadkin Project presents a rare opportunity to hold a Licensee accountable and to ask FERC to condition the new license for APGI (which is worth millions of dollars in revenues annually) on the expenditure of Project revenues to clean up the Badin site.

That way, the community gets faster clean-up and the State is assured that the funds are available. If Alcoa is unwilling to undertake responsibility for the clean-up on a timetable that is reasonable, then it appears that it should, at a minimum, assure the State that it will establish a fund to mitigate the damage it has created and that would avoid the further contamination of the waters and lands in Stanly County.

Understanding the environmental mitigation alternatives that could be made available through the current relicensing—or could be provided by the State of North Carolina if it were to own the Yadkin Project after federal recapture—is critical to the ERC's evaluation of the impacts to the State of a new Yadkin license. Where, as here, neither Alcoa's proposed new license, nor the new license recommended by FERC Staff in its Final EIS, includes any such mitigation measures as mandated license conditions in a new license, the ERC should consider the impacts of those business-as-usual proposals versus more active mitigation that would be available under alternatives to a new Alcoa license.

C. The State's Department of Water Quality and the 401 Certification

The Yadkin Project includes the Narrows Dam (the "Dam") on Badin Lake. The Lake, in turn, is a significant, 5,300-acre water body located along Stanly County's northeastern edge that serves as a primary drinking water source and is a heavily used fishing and swimming lake. The County is vitally interested in the quality of the water in the Lake, and will participate in the State's DWQ hearing; the DWQ is authorized to decide whether to deny APGI's request for a Section 401 water quality certificate or ensure that any such certification addresses documented water quality issues.

This is the second time that DWQ has considered APGI's application for a Section 401 certification for the Yadkin Project. The County challenged the first certification (issued on

November 16, 2007) through a contested case proceeding, believing strongly that DENR did not adequately probe and properly consider water quality concerns and/or impacts that will arise from hydropower operations, before signing off on a certificate. During that contested case, the evidence was strikingly clear that the County's fears were well-founded. We are now highlighting that evidence to the ERC, expressing our disappointment at DWQ's constrained view of its jurisdiction and presenting an expert report previously provided to DWQ from one of the country's best known water quality experts, demonstrating that there are serious water quality issues in Badin Lake that fall directly within DWQ's Section 401 jurisdiction. *See* **Exh. A.**

Finally, it should be understood that the Section 401 certification is a required component of the FERC licensing process. Without the State's approval or waiver of the Section 401 water quality certificate, FERC cannot issue a license. 33 U.S.C. § 1341(a)(1) (providing that FERC may not issue a license for a hydroelectric project unless either the license applicant obtains water quality certification from the state in which the discharge will originate, or the certifying agency waives certification). Furthermore, in prescribing conditions in the Section 401 Certificate, the State is allowed broad discretion to include those terms that are relevant for purposes of achieving the state's water quality criteria, as discussed in the U.S. Supreme Court cases below.

D. DWQ Has Inappropriately Limited its Own Section 401 Jurisdiction Such That It Cannot Adequately Protect Water Quality as Mandated by the Clean Water Act

Stanly County provided DWQ a detailed letter, dated November 9, 2007, which described several significant water quality issues impacting the Lake. See **Exh. I.** The issues in that letter related primarily to the presence of significantly contaminated sediments at several locations in Badin Lake, and we described how those conditions would directly impact water

quality within DWQ's jurisdiction. The contamination, in turn, was documented in several reports from different sources and consultants. Stanly County was surprised and disappointed to learn in the contested case that these conditions were not evaluated and that DWQ did not read the reports that the County brought to its attention. We were just as surprised to learn that DWQ does not intend to read the reports, inquire further of APGI or otherwise evaluate the issues that we raised.

As matters have evolved, Stanly County and DWQ have diametrically opposed views of DWQ's Section 401 jurisdiction. In DWQ's view, it appears that a clear, detrimental water quality condition can exist in the Lake and DWQ will not attempt to address it under the Section 401 program unless some party can demonstrate that the operation (although, apparently not the existence) of the Dam directly affects that condition in a very specific way. Thus, as representatives of DWQ have explained it, the presence of confirmed high levels of polyaromatic hydrocarbons in Lake sediments cannot even be considered in the Section 401 review because they were not initially caused by Dam operations and/or Stanly County did not show DWQ by expert evidence that Dam operations would cause those sediments to impact water quality.

Stanly County submits that this view is inappropriate for at least two basic reasons. First, as DWQ has acknowledged, the concept of "water quality" is quite broad, and encompasses many factors beyond "just" numerical levels. In Badin Lake, these factors include fishing, recreation, biological integrity and several other aspects of the "best usage" of the water. Certainly, the conditions that we highlighted can impact these factors directly.

Second, and importantly, DWQ can and should extend its Section 401 jurisdiction to all water quality issues that exist in the Lake and that relate in any reasonable fashion to the presence of the Project, including the impoundment of water by the Project's dams, the operation

of the dams, stream flows, water levels, the use of the Lake for recreation and the like, since there is no other agency that currently performs this evaluation on behalf of the State in the FERC relicensing process. As a practical matter, this scope of examination is probably assumed to be the case, as the FERC licensing process allows no other agency to evaluate this aspect of Project operations, and the legitimate issue is: how do the Project's operations, both current and proposed, affect the condition of the environment? The broad reach of DWQ's jurisdiction and the expectation of the Clean Water Act statute was confirmed by the United States Supreme Court in PUD No. 1 of Jefferson County v. Washington Dep't of Ecology, 511 U.S. 700 (1994). In PUD, the applicant for a FERC license argued, as does Alcoa here, that a Section 401 certification can consider only those impacts related to an actual discharge from a dam/project (the discharge from the end of a tailrace, in that case). The Supreme Court explicitly rejected this limited view, holding instead that:

> Section 401(d) thus allows the State to impose "other limitations" on the project in general to assure compliance with various provisions of the Clean Water Act and with "any other appropriate requirement of State law." . . . Section 401(d) is most reasonably read as authorizing additional conditions and limitations on the activity as a whole once the threshold condition, the existence of a discharge, is satisfied.

Id. at 711-12 (emphasis added). The petitioner in PUD also argued that the State could not force it to operate its dam in a manner consistent with a designated "use," but the Supreme Court rejected that position, as well. The Court in fact confirmed that the State could impose, for example, minimum flow requirements to protect uses such as drinking water, recreation, navigation or, in that case, a fishery. Id. at 719.

Through its decision in PUD, the Supreme Court has confirmed that DWQ should not limit its review to only those conditions actually caused or otherwise somehow affected by the

operation of the Dam itself. The Section 401 process is DWQ's chance to impose conditions on the "project in general" and "the activity as a whole" to ensure that State law is being met, including the State law related to the protection of best uses of the Lake. Certainly the Lake itself, which would not exist but for the Dam, is part of the "project in general," whether or not Alcoa operates the Dam in any particular fashion. Certainly, as well, under this broad authority DWQ may recognize that contaminated sediments are present, and it is within its authority to require that Alcoa address them so that the "activity as a whole" (that is, the Project's operations) meets water quality standards. Again, DWQ has recognized that the issues raised by the County do indeed constitute adverse impacts to water quality. Now is the opportunity for DWQ to require investigations and impose conditions necessary to ensure that those water quality impacts are addressed and that the best uses of the Lake are protected.

E. The 401 Certification in the FERC Licensing Context

DWQ's authority to view the "project in general" is very broad in a FERC context precisely because the rights and powers conferred by FERC on Alcoa are so comprehensive. The FERC license empowers (and in fact requires) Alcoa to control the entire lake system, including uses of the Lake and the control of the waterways. The "activity as a whole" therefore must necessarily include the same kinds of uses that are included in North Carolina's water quality standards, such as recreation, fishing and the like. In other words, once the "discharge" from the Dam invokes Section 401 jurisdiction, DWQ may legitimately impose appropriate conditions on all aspects of Alcoa's activities authorized by the FERC license, including the maintenance of the Lake. See PUD, 511 U.S. at 724-25; S.D. Warren Co. v. Maine Bd. of Envt'l Protection, 126 S.Ct. 1833, 1848 (2006) (holding that a discharge from a dam is a "discharge" that meets the threshold requirement for Section 401 jurisdiction). DWQ's failure to do so is a

missed opportunity to protect the State's interests as a condition of Alcoa's receipt of a new 50-year FERC license, inasmuch as without a Section 401 water quality certificate, FERC cannot issue a license. 33 U.S.C. § 1341(a)(1).

Moreover, beyond DWQ's authority to impose conditions in a Section 401 certification or deny a Section 401 certification (which conditions or denial must be accepted by FERC), there are not likely any other State agencies that can impose dam and lake system operating conditions on Alcoa as a FERC licensee. So if DWQ chooses not to protect the Lake so the public can use it safely and well, then who will? Who will ensure that the Lake is operated over the next 50 years in a fashion to protect water quality? If DWQ elects to artificially restrict its jurisdiction under Section 401, the State will essentially abdicate its independent role as the arbiter of water quality matters in a FERC project.

F. DWQ's Internal Process May Need Review

As we understand the situation from discovery in the contested case, DWQ decided that, in FERC projects, it would not consider water quality issues that derived from "watershed effects," unless those effects were the direct result of operating the dam at issue. By so doing, it ignored the possibility of improving the existing water quality situation by changes in Project operations, even though the direct or major source of the contamination might result from a non-Project source. Whether the DWQ is aware of the implications of its decision is not clear. However, this decision was made internally by DENR personnel, was not subject to rulemaking or guidance and was apparently not based on any legal opinion or interpretations.

Moreover, it became clear that DWQ could not consistently apply its "rule" as it decided that some conditions that derive from or relate to the "watershed" (such as the sedimentation issues raised by the City of Salisbury or the shoreline management plan) were subject to Section

401, while others (such as the presence of contaminated sediments or the potential for impacted fish populations) were not. In the latter case, it appears that DWQ conducted no material analysis or review, even of the basic data, in reaching its conclusion.

The problem is that the DWQ's rule could allow the water quality in a large impacted water body to deteriorate. In a FERC context, the Section 401 certification offers DWQ a realistic and appropriate chance to improve water quality by imposing conditions on "the project in general" that implement "appropriate requirements of State law," including among other things the best usage and biological integrity of the State's waters. Obviously, any remedial measures would have to recognize those effects not linked to hydro operations so they would not become the responsibility of the licensee by the happenstance of timing. At this time, Stanly County relates its experience to provide the ERC with information and to ask whether the public might not be better served by avoiding the line-drawing and arbitrariness that inevitably derives from proceeding in the absence of formal rules or guidance. In this case, had a better rule been in place, the DWQ might not have initially thought itself precluded from applying the proper standard in the once-in-50-year opportunity to improve the Yadkin River and provide for future uses and improvements. The following are two examples of the inadequacy of the DWQ review.

1. Dr. Rodgers' Report

To assist the County in presenting the specific water quality issues in the Lake, we retained Dr. John Rodgers of Clemson University. Dr. Rodgers is a renowned expert on precisely the matters now before DWQ, and his enclosed 67-page curriculum vitae details his vast knowledge of water quality matters. See **Exh. J.** He is particularly knowledgeable on water quality issues resulting from or related to hydropower dam operations, and currently advises

clients and state governments on such matters (including Section 401 issues). Dr. Rodgers reviewed several reports related to water quality issues in the Lake, including many authored by DWQ itself, and prepared an expert report of his own. See **Exh. A.**

The report is comprehensive and speaks for itself. In brief, Dr. Rodgers concludes that testing and evaluation over the past several years, including during the RSA process, revealed numerous issues, and he highlights the "top ten" that he discovered. These include sediment release and transport impacting ecological resources, the presence of *lyngbya wollei* (an invasive and toxic algal species), releases of suspended solids, poor dissolved oxygen profiles, releases of toxic elements, the impact of Dam operations on eutrophying nutrients, bioconcentration and other effects of toxic compounds in downstream biota, general water quality for spawning and support of aquatic life, the impact of strong seasonal stratification in the Lake and water quality issues coupled with drought planning. See **Exh. A.** Even with these many serious items, Dr. Rodgers was careful to note that his list of water quality concerns is not exhaustive. Clearly there are issues in the Lake that DWQ did not, but should, address in its review of APGI's Section 401 certification application.

Importantly, Dr. Rodgers also highlights how Dam operations can and do affect the water quality issues that he has highlighted, and he cites numerous scholarly references to substantiate his conclusions. He notes, for example, that fined-grained sediments can readily be transported in river systems, including those with dams, and that "movement of contaminants downstream from a reservoir through dam operations is common." See **Exh. A.** He points out, among other things, that contaminants may be mobilized and transported so as to pose risks to humans and downstream biota, that sediments can become suspended in the water body, that redox conditions in the reservoir can lead to the release of certain elements and contaminants and that water

releases from the Dam are important in controlling adverse water quality conditions that are present in the reservoir and downstream of the Dam. He also highlights that there are practical ways to address some of these issues such as, again, by regulating water levels and releases. Clearly, additional review and consideration is warranted, but for now Dr. Rodgers concludes his review of water quality conditions by noting that the Dam's operations can adversely impact water quality and exacerbate existing conditions, and through proper regulation, may help to avoid and solve problems. See **Exh. A**. Therefore, even using DWQ's restricted view of its Section 401 jurisdiction, all of these conditions fall squarely within DWQ's purview and should be evaluated and addressed in the Section 401 process.

It appears that these problems were nevertheless not addressed in any substantive way in the former Section 401 certification.

2. The Dissolved Oxygen Example

The dissolved oxygen issues provide a prime example. DWQ acknowledged in the contested case that discharges from the Dam are now violating and will continue to violate water quality standards for dissolved oxygen. While the past Section 401 certification included a timeline for equipment upgrades, those upgrades extend years into the future and are not certain to bring the discharges into compliance. Based on the current information that we have, it also seems that DWQ did not consider other options, such as regulating water releases or implementing other techniques to address dissolved oxygen or the effects of low dissolved oxygen discharges. In the meantime, while we wait for future equipment upgrades, the water quality in the Lake will continue to be degraded and harm will come to the environment. While we understand that DWQ balances these considerations and decides whether they can be

mitigated, where such obvious adverse effects go untreated for potentially years, we submit that the Dam activity will continue to degrade the existing uses of the Lake and waterway. In this circumstance, DWQ's regulations dictate that the Section 401 certification should not be granted. 15A NCAC 02H .0506. Dissolved oxygen is just one of the many serious issues identified by Dr. Rodgers that are currently resulting from Dam operations.

Stanly County's concerns arise from two sources: whether the DWQ can and will impose conditions to address the matters noted by Dr. Rodgers, and whether it will take the responsibility to properly understand those conditions and how they can be mitigated or affected by Dam operations. To fulfill its responsibilities, DWQ must undertake further detailed evaluation of these matters, and it should review the reports that the County identified and coordinate with the State's own experts to determine how best to proceed. In the contested case, DWQ itself described its process for evaluation of water quality impacts as screening for initial impacts and then further investigating the nature and extent of the issues. We agree with this approach, and ask that the ERC urge DWQ to implement it in the present federal licensing case.

G. The allocation of water for non-power uses from the Yadkin Hydroelectric Project.

House Bill 2499, "An Act to Improve Drought Preparedness and Management in North Carolina," was at the top of Governor Easley's and DENR's legislative agenda this session. The final version of the bill was the result of a lengthy "605 Work Group" process which included numerous interested parties.

The bill calls for cities and counties to obtain DENR approval of water shortage response plans developed pursuant to Environmental Management Commission (EMC) rules that became effective in 2007. Systems without plans must implement default conservation measures developed by the state. Pursuant to the bill, DENR will require that local plans provide for

increasingly stringent conservation measures and the department is authorized, in an extreme or exceptional drought, to require water systems to move to the next state of response in their plans if lesser measures are not effective.

The Governor and DENR lobbied for this increased centralized control over local water management, arguing it was necessary to protect the public. However, with little fanfare, the legislature included a provision stating that none of the local drought management or state minimum conservation measures contemplated by the legislation may be implemented if they conflict with "any license for a hydroelectric generating facility issued by the Federal Energy Regulatory Commission (FERC)." See G.S. 143-355.2(j). Instead, if FERC approves the Relicensing Settlement Agreement that Alcoa has proposed in the current FERC relicensing proceeding, Alcoa would be bound by the Low Inflow Protocol it negotiated in that proceeding. The state could not require modification of the Low Inflow Protocol in response to changing conditions.

Thus, a new fifty-year FERC license would exempt Alcoa from efforts by state and local leaders to responsibly prepare for and manage future droughts pursuant to North Carolina policy. For example, while other members of the community are being subjected to increasingly stringent water conservation measures pursuant to DENR approved local management plans and EMC minimum standards, Alcoa will not be held to an equal standard if doing so conflicts in any way with the company's FERC license.

HB 2499 also makes clear that none of the Governor's drought emergency powers may be implemented if they conflict with "any license for a hydroelectric generating facility issued by the Federal Energy Regulatory Commission (FERC)." See G.S. 143-355.3(e). Thus, even in an emergency, Alcoa would be empowered to abide solely by the Emergency Protocol negotiated in

connection with the company's FERC license, rather than the emergency measures called for by our Governor pursuant to the authority granted by House Bill 2499. For example, in a true drought emergency, if the Secretary of DENR adopts rules governing the use of water so as to maintain essential water use, Alcoa would be exempt from compliance to the extent the Secretary's emergency rules conflict with the power granted by Alcoa's FERC license.

One of the standard conditions included in FERC licenses provides for the licensee to receive compensation for non-power uses of project waters by other entities. This provision applies to state and municipal uses, as well as private water users. Thus, if Alcoa is granted another 50-year license, and the State of North Carolina wanted to make reasonable use of a reservoir licensed to Alcoa, for the purpose of protecting the public water supply, Alcoa would likely take the position that the State must first request permission from Alcoa and FERC. Even assuming the request were approved, the standard license condition provides that Alcoa could demand that the State compensate Alcoa for any electricity sales revenue lost as a result of the State water use.

In addition, the FERC license conditions proposed by Alcoa would empower the company to do the following:

(1) Operate High Rock reservoir within 4 feet of full pond from April 1 to October 31 and within 10 feet of full pond from December 1 to March 1, except as needed to maintain flows or as provided under the Low Inflow Protocol or the Hydro Project Maintenance and Emergency Protocol. The proposed Low Inflow Protocol sets target flows of as low as 950 cfs for stage 2 droughts and 770 cfs for stage 3 droughts. Only under stage 4 droughts would consensus among Alcoa Generating and state agencies be required to determine any additional measures to be implemented.

(2) Operate Tuckertown, Narrows, and Falls reservoirs within 3, 5, and 4 feet of their full ponds, respectively, except as needed to maintain flows or as provided under the Low Inflow Protocol or the Hydro Project Maintenance and Emergency Protocol.

(3) Provide daily average seasonally adjusted minimum flows from the Falls development of 1,000 cfs from June 1 to January 31, 2,000 cfs from February 1 to May 15, and 1,500 cfs from May 16 to May 31.

(4) Maintain reservoir water elevations at all four developments from April 15 through May 15 of each year no lower than 1.0 foot below the elevation of each reservoir recorded on April 15(with provision for specific exceptions).

(5) Develop and implement its own flow and reservoir elevation monitoring and compliance plan.

Given the continued severity of North Carolina's drought, and the emphasis placed on the protective measures of House Bill 2499, our state and local leaders must have the ability to make timely, and event-specific decisions about our water supply. Effectively exempting Alcoa from this decision-making process fundamentally undermines this ability.

NEXT STEPS

Stanly County respectfully requests that, at the outset, the ERC take following actions to assure a complete and adequate study on the issue of the Yadkin River's use:

1. Disclosure by Alcoa and APGI of all information it has or has knowledge of, regarding environmental contamination at the Badin Smelting Works and known waste disposal sites, including potential health hazards posed by such contamination;

2. Comprehensive screening and, where appropriate, in-depth site characterization, of Alcoa-owned property in Stanly County outside the Badin Smelting Works, where informal, off-site hazardous smelting waste disposal may have occurred during the past 100 years;

3. Disclosure by Alcoa/APGI of past Alcoa arsenic emissions and their impact on the land and water resources of the Project area, as well as interconnected land and water resources that could affect the Project features, including Badin Lake;

4. Disclosure by Alcoa/APGI of all information it has or has knowledge of, regarding environmental contamination of Badin Lake;

5. Acquire and if time permit, conduct additional detailed studies of environmental contamination of Badin Lake and other reservoirs supplying water, including testing for contaminants, including arsenic.

After preparing its studies, Stanly County recommends, based on its experience to date, that the ERC consider among its proposals to best assure the State's ability to provide for the clean, safe and adequate furture use of the water flows of the Yadkin River, the following:

6. Mitigation of the County's infrastructure costs, which will include mitigating the detrimental impacts on residents who were encouraged to come to the area and lay down their roots because of Alcoa's need for workers;

7. Consideration of mitigation measures to: (a) monitor the changing environmental situation; (b) clean up contaminated sites and fund technically feasible methodologies to avoid penalizing Stanly County and its residents for hosting Alcoa's operations and to safeguard the County's right to a decent future; and (c) identify all contamination resulting from the Licensee's historical smelting operations to allow proper public notice and opportunitites for mitigation; and

8. The State of North Carolina should request the federal government to exercise an option, available under federal law, to purchase the Yadkin Hydroelectric Project. In exchange, the State would reimburse the federal government for the purchase price and assume the ownership and control of the Yadkin Project, for the benefit of the people of North Carolina. Ownership would enable the State to better control the flows of the Yadkin River in the interest of the public and the citizens of North Carolina.

IX. CONCLUSION

FERC's relicensing decision will determine the fate of the Yadkin River for years to come and will measurably affect the ability of this waterway to meet the public's needs and to make the lives of thousands of people in the area better. Through this study, Stanly County hopes that the ERC will make recommendations that ensure that the citizens of North Carolina benefit from what rightfully belongs to them – the water.

Respectfully submitted,

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LOBBYISTS FOR STANLY COUNTY

SB 1046: Yadkin Project Study

INFORMATION OF POTENTIAL INTEREST TO THE ERC

I. FINANCIAL INFORMATION

1) The annual gross revenues received by Alcoa from sales of electricity from the Yadkin Project.

2) The annual gross revenues received by Alcoa from sales of environmental attributes from the Yadkin Project, with a description of the specific environmental attributes sold.

3) An estimate of anticipated revenues from sales of electricity from the Yadkin Project for the period May 2008 through April 2058.

4) A schedule of substantial repair and/or capital improvements projected for the Yadkin Project over the next 20 years, and the impact of implementing such repairs on the Project revenues.

5) A summary of Alcoa's plans or arrangements for selling the Yadkin Project output and environmental attributes in the next 20 years.

6) The water revenues associated with the Yadkin Project received by Alcoa over the past 25 years.

7) The costs incurred by Alcoa in the relicensing of the Yadkin Project, to date.

8) The annual operating costs of the Yadkin Project.

II. ENVIRONMENTAL ISSUES

9) The anticipated date/schedule for completing the removal of all hazardous wastes from Alcoa's Badin Plant and other Alcoa-owned real property in Stanly County?

10) Will the land subject to the clean up be available for commercial and industrial uses after the scheduled "final clean up"?

11) Have Alcoa and DENR reached an agreement as to when the Yadkin Project will be required to conform to State Dissolved Oxygen standards?

12) The dates and results of the most recent available water quality and sediment sampling for each impoundment and tailrace in the Yadkin Project.

13) The dates and results of the most recent available water quality and sediment testing of Little Mountain Creek downstream of the Old Brick Landfill, and of Mountain Creek after its confluence with Little Mountain Creek.

14) The dates and results of the most recent available groundwater quality tests conducted in or near the community of Badin.

15) The dates and results of the most recent available soil sampling conducted around the perimeter of Badin Lake.