

LATERAL 10 VENTURES LIMITED PARTNERSHIP

IBLA 93-327

Decided August 7, 1995

Appeal from a decision of the District Manager, Burley District, Idaho, Bureau of Land Management, establishing fair market rental for small hydroelectric project right-of-way. I-20078.

Affirmed.

1. Appraisals—Rights-of-Way: Appraisals

BLM's determination of the fair market rental for a right-of-way for a hydroelectric project will be affirmed where the holder fails to demonstrate, by a preponderance of the evidence, that BLM's appraisal methodology (assessing a percentage of the gross income received from the sale of electricity generated by the project) was improper; that it used inappropriate data, erred in its calculations, or otherwise arrived at a rental that deviated from fair market value; or that the rental should be reduced or waived since the holder provides a valuable benefit to the public.

APPEARANCES: Stephen M. Harmsen, President, Lateral 10 Ventures Limited Partnership, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Lateral 10 Ventures Limited Partnership (Lateral) has appealed from the April 6, 1993, decision of the Burley, Idaho, District Office, Bureau of Land Management (BLM), establishing an annual fair market rental of \$7,520 for its hydroelectric project right-of-way (I-20078).

The right-of-way was granted on February 6, 1984, for a term of 75 years (subject to renewal), pursuant to Title V of the Federal Land Policy and Management Act of 1976 (FLPMA), as amended, 43 U.S.C. §§ 1761-1771 (1988). It was later amended on October 1, 1984. <sup>1/</sup> The project is

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<sup>1/</sup> The grant was originally issued to Cogeneration, Inc. (Cogeneration). The 1984 amendment recognized that Cogeneration had been reconstituted as Lateral for purposes of the hydroelectric project.

situated on private and public land in Twin Falls County in southwestern Idaho and involves the diversion of up to 75 cubic feet per second of water from the "Lateral 10" irrigation ditch off of Deep Creek, a tributary of the Snake River. The water is carried 0.62 miles in penstocks and a canal to a power generating facility in the Salmon Falls Canyon, losing 478 feet in altitude. The water runs through a turbine/generator housed in a small building and empties through a tailrace into Salmon Falls Creek. The voltage of the electricity produced is stepped up in transformers, carried 1.08 miles through transmission lines to an electrical substation, and sold to the Idaho Power Company (Idaho Power). The project also encompasses a 1.46-mile-long access road.

In total, 1,469.65 feet of penstock and canal, the power generating facility, 0.58 miles of transmission line, and 1.06 miles of access road are situated on 9.55 acres of public land. The right-of-way grant was amended on October 7, 1987, to permit the location of a mobile home, serving as an office and overnight quarters for Lateral's personnel, on this land. The remainder of the project is on private land.

When issued on February 6, 1984, the right-of-way grant provided that the annual rental would be \$800, subject to an appraisal. This figure was termed an "estimated interim rental" that might be adjusted if it differed from the final appraised figure. <sup>2/</sup> This term remained in effect through subsequent amendments of the grant. The rental was paid by Lateral before the anniversary date (February 5) from 1985 to 1994.

At the time the grant issued, the necessary water rights permit for the diversion and use of water from Deep Creek had been obtained from the Idaho Department of Water Resources, an agreement had been entered into with the Twin Falls Canal Company (which holds the water rights and operates the Lateral 10 irrigation ditch), and an exemption from the licensing and other requirements of Title I of the Federal Power Act, as amended, 16 U.S.C. §§ 791a-823a (1988), had been obtained from the Federal Energy Regulatory Commission (FERC). Thereafter, a 35-year agreement for the purchase of electricity generated by the project was entered into with

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<sup>2/</sup> BLM explained in a Sept. 30, 1982, memorandum to the District Manager that the interim rental had been estimated on the basis of a percentage of the fee value of surrounding land use or land use potential. However, it stated that:

"As comparable market data becomes available, it may become necessary to revise the method used for estimating fair market rentals for rights-of-way. \* \* \* Other methods such as taking a percentage of gross income \* \* \* may be employed. If we find that such methods more accurately reflect the rental value of private market transactions, we will then be obliged to utilize that approach."

Idaho Power, financing was procured, and the hydroelectric and related facilities were constructed. The project began operation in June 1985.

In 1987, BLM began its appraisal of the fair market rental value of the right-of-way grant. BLM's Appraisal Report was dated February 19, 1993, and approved by the Chief State Appraiser, Idaho State Office, BLM, on March 16, 1993. In determining what its appraisal methodology should be, BLM surveyed 16 leases of private land for hydroelectric purposes in Idaho. It found that rental on these private leases was generally determined by the "royalty method," *i.e.*, a percentage of the gross income derived from the sale of electricity generated by operation of the permitted hydroelectric facility (Appraisal Report at 17 and 21). The private leases charged from 0.5 to 15 percent of gross income. *Id.* at 17 and 20. In each case, the specific percentage was applied to the prior year's gross income to derive the rental for the ensuing lease year (BLM Instruction Memorandum (IM) No. ID-93-010 (Oct. 22, 1992) at 1).

BLM compared Lateral's right-of-way to the 16 private land leases in terms of the following factors that they used to set an appropriate royalty rate: the time when the rental was established; the proportionate contribution of the permitted project to the total force of the water through the powerhouse (as reflected in the change in elevation from the point of water diversion to the powerhouse, *i.e.*, the "head"); the ratio of the total distance from the point of water diversion to the powerhouse to the head; and the number of components of the project located on the permitted land or lands (Appraisal Report at 5, 23-25). <sup>3/</sup>

BLM found 5 of the 16 private leases comparable to Lateral's right-of-way; those 5 have royalty rates from 1.5 to 12.5 percent. *Id.* at 25-29. BLM considered the right-of-way most comparable to two of the leases, which charged 5 percent. *Id.* at 29-30. Perhaps coincidentally, half of the 16 private leases had royalty rates at or around 5 percent, with the average of all of them at 5.44 percent. *Id.* at 30. BLM considered 5 percent the maximum percentage of gross income that could be charged in a private lease

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<sup>3/</sup> BLM noted that the passage of time has resulted in a decrease in the royalty rates adopted in private leases, due to changes in allowable rates paid by electric utilities and in Federal energy and investment tax credits applicable to hydroelectric projects (Appraisal Report at 22 and 24). However, BLM also indicated that the greater the proportion of the head attributed to the permitted land, the more electricity (and thus the more revenues) could be generated by that land. *Id.* at 24. Also, a smaller ratio of length to head meant that the head would be produced at less cost, due to the smaller length of the canal/penstock that must be constructed for the project. *Id.* at 23. BLM also noted that a higher royalty rate would likely be charged where more of a project was located on permitted lands. *Id.* at 23 and 25.

comparable to the right-of-way, assuming that 100 percent of the project was on the permitted land. Id. at 30.

BLM made adjustments in order to take into account differences between the right-of-way and the comparable leases. It reduced the percentage of gross income to account for the fact that, unlike the comparable private leases, the gross income was generated by a project not entirely located on land owned by the permitting party. BLM did that by considering a hydroelectric project to be composed of eight basic components essential to the production of electricity: water, diversion structure, reservoir and/or canal, penstock, powerhouse, tailrace, interconnecting powerline, and road access (Appraisal Report at 18). BLM found that the percentage of gross income used in the private leases was not tied to the particular component or components of the hydroelectric project on the leased land. Id. at 18, 21. However, it concluded that the overall percentage should be adjusted to reflect whether the lease encompassed one, some, or all of the components it identified. Id. at 18.

BLM attributed equal weight to each component, since it considered each as necessary to the overall success of the project as an income-generating operation (Appraisal Report at 18-19; Issue Paper at 2-4). <sup>4/</sup> Thus, each of the eight components was deemed to contribute 12.5 percent of the total income generated by the entire project (Appraisal Report at 19). BLM concluded: "[E]ach component reflects 12.5 percent of the maximum percentage of gross [income] that might be paid to a [private] lessor. For each component found on a given BLM tract, up to 12.5 percent of the maximum percentage of gross income could be charged." Id.

BLM found six components of Lateral's project to be situated in whole or in part on public land: canal, penstock, powerhouse, tailrace, inter-connecting powerline, and road access (Appraisal Report at 18). As only part of the canal, powerline, and road access were on public land, it reduced the percentage of income attributed to those three components depending on the percentage of the component on public land. <sup>5/</sup> Id. at 19.

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<sup>4/</sup> The full title of the Issue Paper is "Proposed Valuation Methodology for Estimating Fair Market Rent of Hydro Power Sites on BLM Lands." It is dated July 26, 1989, and appears in the record attached to an Aug. 1, 1989, Memorandum to State Director, Idaho, BLM, from Deputy State Director for Operations, Idaho State Office, BLM.

<sup>5/</sup> BLM found that 519.84 out of 2,318.84 feet of the canal were on public lands, i.e., 22.4 percent. It applied that percentage to the 12.5 percent attributed to the factor as a whole (id. at 5), thus allocating 2.80 percent of the income to the canal. BLM allocated 53.7 and 73.0 percent of 12.5 percent (6.71 and 9.13 percent) of the income, respectively, to the powerline and road access.

The percentages of income attributable to the various components were then added together. Id. at 19, 30.

BLM concluded that 56.1375 percent of the gross income generated by Lateral's hydroelectric project was attributable to the part of the project on public lands (Appraisal Report at 19). Thus, multiplying the maximum it found it could charge (5 percent) by 56.1375, it arrived at 2.8069 (rounded to 2.8) percent as the percentage of gross income that could be charged as rent for the BLM right-of-way. Id. at 19, 30.

BLM further reduced this percentage by 0.25 percent to account for the fact that the project provided a limited benefit to the public in the form of improved vehicular access over a graded/graveled road down to Salmon Falls Creek. The adjustment was small, as this access was not identified as available for public use and depended on whether the gate at the top of the hill was left unlocked (Appraisal Report at 31). <sup>6/</sup> Thus, BLM reduced the allowable percentage of gross income from 2.8 to 2.55 percent. This percentage was approved for use for the 5 lease years ending in 1994 through 1998. Id. at iii.

Applying this percentage to Lateral's estimated gross income for the lease year ending in 1992, BLM concluded that the fair market rental of Lateral's right-of-way for the year ending in 1993 was \$7,522.04 (rounded to \$7,520) (Appraisal Report at 1, 32).

In his April 1993 decision, the District Manager notified Lateral that, based on its appraisal, BLM had determined, in accordance with 43 CFR 2803.1-2(c)(3)(i), that the annual rental for the period from February 6, 1993, through February 5, 1994, was \$7,520, which was 2.55 percent of Lateral's estimated gross income for 1992. <sup>7/</sup> In order to conform the rental period to an annual billing cycle beginning on July 31

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<sup>6/</sup> Citing two comparable State leases, BLM noted that providing a road down a cliff face in one of these leases had possibly resulted in a reduction of 1 percent in the percentage of gross income the State used to calculate rent. Id. However, a 1-percent reduction for Lateral's right-of-way would have reduced the percentage to 1.8 percent, below that of the State lease with the road (2 percent). Further, since the public benefit afforded by the State lease was greater, due to the difficulty of road construction, and since BLM could not definitely credit all of any applicable reduction to the road, it arrived at a 0.25 percent reduction.

<sup>7/</sup> It appears that, pursuant to 43 CFR 2803.1-2(b)(2)(iv), BLM waived collection of back rental, based on the royalty appraisal method adopted in February 1993, for any of the lease years prior to the lease year ending in 1993, presumably because of the economic hardship it would impose on the right-of-way holder. That policy had been adopted by the State Director, Idaho, BLM (see IM No. ID-93-010 at 3).

of each year thereafter, the District Manager provided for a prorated advance rental for the period from February 6, 1994, through July 30, 1994, in the amount of \$3,760. Thus, Lateral was deemed to owe a total of \$11,280, which BLM required it to pay within 30 days of receipt of the decision. <sup>8/</sup> Lateral has appealed from the April 1993 BLM decision.

[1] Lateral objects to BLM's methodology for determining the rental for a hydroelectric project right-of-way, contending that it is improper to charge a percentage of the gross income received before the project has started.

Section 504(g) of FLPMA, as amended, 43 U.S.C. § 1764(g) (1988), and its implementing regulations (43 CFR 2803.1-2(a)) require the holder of a right-of-way grant to pay annually to the United States the fair market rental value for the right-of-way. The rental is to be based on either a "market survey of comparable rentals" or a "value determination." 43 CFR 2803.1-2(c)(3)(i). Here, BLM used a market survey approach, determining first that the market generally charged a percentage of gross income for comparable private land leases for hydroelectric purposes and then deriving an appropriate percentage from a review of such leases, which percentage was adjusted to account for differences between the right-of-way and the comparable leases.

We find no fault with BLM's adoption of the royalty or percentage of gross income method for determining fair market rental value. Rental value was determined based on a review of comparable leases, which is the preferred approach, and thus is consistent with "comparable commercial practices," as required by 43 CFR 2803.1-2(a). See Bear Creek Hydro (On Reconsideration), 124 IBLA 225, 229-30 n.3 (1992); <sup>9/</sup> Bear Creek Hydro, 122 IBLA 200, 208 (1992); Laguna Gatuna, Inc., 121 IBLA 302, 306-07 (1991).

Nor can we discern any error by BLM in its application of this appraisal methodology, including the manner in which BLM adjusted the maximum percentage taken from comparable leases so as to account for the extent to which the permitted land use is on public lands. See Laguna Gatuna, Inc., 121 IBLA at 304, 307. Also, Lateral has shown no inaccuracy in the data used in BLM's appraisal or in its calculations.

Lateral's sole objection to BLM's approach is that it cannot be properly employed prior to the start of a permitted hydroelectric project. <sup>10/</sup>

<sup>8/</sup> BLM credited Lateral with \$800, which it had previously paid.

<sup>9/</sup> We set aside BLM's decision on reconsideration only because BLM had failed to properly substantiate its adoption of a 4-percent royalty figure. See Bear Creek Hydro (On Reconsideration), 124 IBLA at 229.

<sup>10/</sup> We note that, in a Jan. 8, 1992, letter, Lateral proposed a version of a royalty method, suggesting that rentals be calculated on the basis of

Although Lateral does not explain the basis for its objection, it appears that it regards the method as improper since there are no revenues from which to calculate a fair market rental. BLM, however, has taken this into account, providing that, in the case of new rights-of-way for hydroelectric projects, it will collect a "deposit" to be set by the State Office, and then proceed to appraise the right-of-way. IM No. ID-91-041 (Dec. 21, 1990). <sup>11/</sup> It will presumably appraise the right-of-way according to the royalty method only following the first year of operation. <sup>12/</sup> In any case, Lateral's hydroelectric project was in its eighth year of operation at the time of BLM's April 1993 decision, so that there clearly were revenues from which a fair market rental could be determined.

Lateral also contends that BLM improperly determined the rental because it had been previously negotiated and cannot be changed during the period of the FERC license. Lateral does not identify what the prior rental was, when it was previously negotiated, or (most importantly) why BLM was, as a result, precluded in April 1993 from determining the rental. The only rental previously negotiated or set by any party to the grant was the \$800 rental established by BLM at the time of the right-of-way grant. There is no question that this rental was intended to be subject to adjustment once an appraisal was performed, and BLM expressly informed Lateral of this fact in the right-of-way grant itself. Issuance of a right-of-way grant subject to later appraisal is consistent with Departmental regulations in effect at the time of the grant and thereafter. 43 CFR

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fn. 10 (continued)

3 percent of net income, that is, revenues from the utility less royalties and rentals paid to others. Lateral provided no support for reliance on a percentage of net income as a means of calculating rent in the private market or justification for the 3-percent figure. In addition, Lateral argued that the project should be broken down into seven components, of which BLM deemed four (canal, penstock, powerhouse, and powerline) pertinent. Without explanation, Lateral failed to account for the tailrace or the road and included two components that are not found on the land (administration and insurance). Otherwise, Lateral generally agreed with BLM in allocating 20, 100, 100, and 50 percent of one-seventh of the income attributed, respectively, to the portions of the canal, penstock, powerhouse, and powerline located on public land.

<sup>11/</sup> That procedure appears to be in accord with 43 CFR 2803.1-2(c)(3)(ii).

<sup>12/</sup> The deposit collected in the case of new rights-of-way will most likely be a "pre-production one-time lump sum value to cover rent during the construction phase of the [right-of-way]," and that, "once power is produced, [the right-of-way will be] appraised by BLM based upon comparable market data, which so far has supported a royalty fee [which] \* \* \* is a percentage of gross income, applied to income from power production for the previous calendar year." IM No. ID-95-017 (Dec. 16, 1994) (emphasis added).

2803.1-2(c)(3)(ii) (formerly 43 CFR 2803.1-2(b) (1983)). We have long endorsed that procedure. See, e.g., Voice Ministries of Farmington, Inc., 124 IBLA 358, 360 (1992).

We can discern no basis for precluding BLM from adjusting the rental for its right-of-way to reflect fair market value, pursuant to section 504(g) of FLPMA, because a permitted project is either licensed or exempt from licensing by FERC. FERC establishes a land-use fee (see 16 U.S.C. § 803(e)(1) (1988), and 18 CFR 11.2), which BLM has chosen to take into account by decreasing its rental by the fee amount in the case of licensed projects. See Bear Creek Hydro (On Reconsideration), 124 IBLA at 227; IM No. ID-93-010 at 2; BLM Manual section 2805.37B (Rel. 2-249 (Oct. 20, 1986)). However, nothing shows Lateral's project is licensed by FERC.

Lateral also contends that, even if BLM properly determined fair market rental on the basis of a percentage of gross income, it failed to take "1992 revenues \* \* \* into account" in calculating the fair market rental for the lease year ending in 1994, noting that they were "as much as 50 [percent] less than previous year revenues." We find no error. BLM admittedly "estimated" Lateral's gross income in 1992 by taking the average amount of electricity generated in any given month in that year by the Lateral facility and multiplying it by 12 months (to reflect annual production) and then by the applicable price for electricity under Lateral's energy purchase contract with Idaho Power (to get expected annual revenues) (Appraisal Report at 32). However, it did so only because Lateral had failed to provide actual revenue figures, despite advance notice from BLM that it intended to use the royalty method of appraisal and solicitation of pertinent information. 13/

Nor has Lateral offered the relevant figures or any evidence to support them on appeal. Although they are assertedly 50 percent less than the figures from the prior year, absent the 1991 figures, we cannot determine what the 1992 figures are, or ultimately what the fair market rental should be for the lease year ending in 1994. In these circumstances, Lateral has failed to carry its burden of demonstrating error by a preponderance of the evidence. See Laguna Gatuna, Inc., 121 IBLA at 306-07. In any event, BLM's method for estimating actual revenues should yield figures close to the actual ones since it relies on electrical production and purchase prices, which together reflect revenues.

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13/ See Sept. 17, 1991, Letter to Lateral from BLM ("The rental charge \* \* \* will be based on a percent of the project's gross income"); Oct. 22, 1991, Memorandum to the File from BLM Real Estate Appraiser regarding Oct. 21, 1991, meeting with Lateral; Dec. 6, 1991, Letter to Cogeneration from BLM; and Jan. 31, 1992, Letter to Cogeneration from BLM.

Finally, Lateral contends that BLM improperly determined the fair market rental because it failed to credit Lateral for any improvements made to the public land, i.e., "roadways, fences, seeding, etc." Section 504(g) of FLPMA provides that a right-of-way "may be granted \* \* \* to a holder where he provides without or at reduced charges a valuable benefit to the public \* \* \* for such lesser charge, including free use[,] as the Secretary [of the Interior] finds equitable and in the public interest." 43 U.S.C. § 1764(g) (1988); see also 43 CFR 2803.1-2(b)(2); William F. Bieber, 82 IBLA 6, 7 (1984).

As discussed above, BLM has already provided a 0.25-percent reduction in the annual royalty rate for the public benefit provided by Lateral in the form of improved vehicular access over a graded/graveled road down to Salmon Falls Creek. <sup>14/</sup> Lateral has failed to demonstrate that any other improvements made to the public lands in connection with construction and operation of its hydroelectric project provide a "valuable benefit" to the public. BLM could find none (see Jan. 15, 1993, Memorandum to Deputy State Director for Operations from District Manager). So far as we can determine, no "fencing" was erected on public land in connection with the right- of-way. The "seeding" that was done simply repairs the damage done to the permitted land by Lateral, restoring the land to its condition prior to issuance of the grant, as required. We, therefore, conclude that Lateral failed to demonstrate, by a preponderance of the evidence, that it provides a valuable public benefit beyond that already recognized by BLM and thus is entitled to an additional reduction of its rental under section 504(g) of FLPMA. See Ruth Tausta-White, 127 IBLA 101, 103 (1993); Delbert Jones, 100 IBLA 289, 292 (1987).

In general, Lateral failed to demonstrate that BLM improperly adopted its appraisal methodology, that there was any error in its application, or that the rental ultimately adopted deviated from fair market value. Nor did it submit its own appraisal of the right-of-way. Therefore, we conclude that BLM properly determined the fair market rental for Lateral's hydroelectric electric project right-of-way I-20078. See Voice Ministries of Farmington, Inc., 124 IBLA at 361; Laguna Gatuna, Inc., 121 IBLA at 306-07. <sup>15/</sup>

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<sup>14/</sup> In the case of the rental found to be owed for the 1993/94 lease year, this translated to a reduction of \$737.46.

<sup>15/</sup> We note that BLM failed to adjust the rental due date of this right- of-way, as required by 43 CFR 2803.1-2(a), which provides that "[a]nnual rent billing periods shall be set or adjusted to coincide with the calendar year (January 1 through December 31) by proration on the basis of 12 months \* \* \*." See Laguna Gatuna, Inc., 121 IBLA at 305 n.6.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

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David L. Hughes  
Administrative Judge

I concur.

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Franklin D. Amess  
Administrative Judge

