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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-080416

EXHIBIT NO. ____ (TEP-3C)

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REPRESENTING AVISTA CORPORATION

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**BACKGROUND OF SETTLEMENT OF CLAIMS
BETWEEN AVISTA CORPORATION AND THE
COEUR D'ALENE TRIBE OF INDIANS**

I. INTRODUCTION

A. Avista's Spokane River Project

Avista Corporation's federally-licensed Spokane River Project is located along the Spokane River in Washington and Idaho. The Project currently consists of the following five hydroelectric development ("HED") facilities: Post Falls, Upper Falls, Monroe Street, Nine Mile and Long Lake.

The initial Federal Power Act ("FPA") license regarding the Spokane River Project was issued on August 17, 1972, and included only the Upper Falls, Monroe Street, Nine Mile, and Long Lake HEDs. On July 22, 1981, the license was amended to include the Post Falls HED. The license of the Spokane River Project expired on August 1, 2007, but has been renewed on a year-to-year basis while Avista's applications for new licenses covering the five HEDs (one application for the Post Falls HED and one application for the other four HEDs) remain pending before the Federal Energy Regulatory Commission ("FERC").

B. The Post Falls HED

Of particular significance in the present case is the Post Falls HED. The Post Falls HED was completed in 1906 and is located nine miles downstream of the Coeur d'Alene Lake ("Lake") outlet, which is the beginning of the Spokane River.

The Post Falls site was originally acquired by Frederick Post from the Coeur d'Alene Tribe of Indians ("Tribe") in 1871. Thereafter, through a series of transactions, Avista purchased the Post Falls site and, as a consequence, became the lawful holder of all rights previously granted to Post.

Beginning in 1907, Avista, in its operation of the Post Falls HED, began holding the Lake at an elevation of 2126.5' above sea level for a portion of each year. This action resulted in outcries of opposition from property owners north of the Coeur d'Alene Indian Reservation ("Reservation") and along the Lake and the Coeur d'Alene River. These property owners, many of whom were ranchers and farmers, contended that by

creating a reservoir and holding the Lake level at 2126.5', Avista was damaging rich agricultural property.

On January 25, 1909, Avista filed an application with the United States Department of Interior ("DOI"), pursuant to the Act of February 15, 1901, requesting permission to overflow to an elevation of 2128' above sea level, certain Reservation lands consisting of approximately 6,240 acres.¹ On February 2, 1909, DOI granted Avista a permit that ". . . shall continue indefinitely and until revoked for good cause by the Secretary of Interior."

After the 1909 Permit was issued, there were further outcries from homesteaders, property owners and communities bordering the Coeur d'Alene River, St. Joe River and the Lake. On April 26, 1909, petitions were filed with the Commissioner of Indian Affairs by citizens of St. Joe, Ferrell, Coeur d'Alene and St. Maries requesting that the 1909 Permit be revoked on the grounds that Avista's use of the Lake as a reservoir caused water to overflow "rich agricultural lands in the valley of the Saint Joseph and Coeur d'Alene Rivers thereby rendering the lands worthless." In response to these petitions, on July 3, 1909, DOI issued an order requiring Avista to show cause why the 1909 Permit should not be revoked.

The hearing on DOI's Order to Show Cause lasted more than three months and included testimony from as many as 175 witnesses. The hearing focused on two central issues: (1) the nature and character of the land affected by the operation of the Post Falls Dam (both inside and outside the Reservation boundaries); and (2) Avista's use of the Lake as a reservoir.

On July 29, 1910, Acting Secretary of Interior, Frank Pierce, issued a decision revoking the 1909 Permit. The central feature of the decision was "technical legal" in nature and was primarily based on the theory that DOI's authority under the Act of February 15, 1901 had been revoked as to the Reservation by the Act of June 21, 1906, which provided for the opening and settlement of the Reservation.

Following the July 29, 1910 decision, Avista filed a petition for rehearing of the Departmental Decision and, on May 2, 1911, that petition was granted by the Secretary of

¹ The Act of February 15, 1901 authorized the Secretary of Interior to grant permits across public and Indian lands for use in electrical power generation, timber retrieval, water supply, and various other purposes. (31 Stat. 790)

Interior. Subsequently, after considering the briefing and argument of the parties involved, the Secretary of Interior reinstated the 1909 Permit. In pertinent part, the Secretary found that, to the extent that Avista may have engaged in trespass by overflowing lands along the St. Joe River, Coeur d'Alene River, and the Lake without a valid permit from 1907-1909, any such trespass was rectified by the issuance of the 1909 Permit.

In 1941, Avista, in its operation of the Post Falls HED, began holding the Lake at an elevation of 2128' above sea level for a portion of each year.

By virtue of the rights acquired from Frederick Post, the rights granted under the 1909 Permit, and the statements of DOI in its decision reinstating the 1909 Permit, Avista believed it possessed all necessary rights to store water on the Lake. Consistent with this belief, between 1907 and 1972, Idaho exercised exclusive ownership of the Lake, and Avista's use of the Lake as a reservoir was unchallenged by any party.

C. The Tribe's Claim of Partial Lake Ownership

After more than 60 years of unchallenged use, the question of Avista's right to use the Lake as a reservoir was called into question in 1973 when, for the first time, the Tribe asserted an ownership interest in the Lake and, on that basis, sought to intervene in FERC proceedings concerning the licensing of the Spokane River Project.

Ultimately, the Tribe's claim of ownership would take more than two decades to resolve. In 1979, in an effort to facilitate a resolution of the Tribe's claims, Avista stipulated to allow FERC to decide the issue. That resulted in (1) a 1980 FERC decision that Idaho owned the Lake; (2) a reversal of that decision in 1983; (3) an appeal to the United States Court of Appeals for the D.C. Circuit; (4) a remand of the issue at the request of FERC; and (5) finally, a decision in 1988 wherein FERC concluded that it lacked jurisdiction to resolve the Lake ownership issue.

Following FERC's decision in 1988, neither DOI nor the Tribe took any further action to resolve the Lake ownership issue until 1992. Likewise, due to the sovereign immunity of the Tribe, the United States and the State of Idaho, Avista had no ability to seek resolution of the issue on its own. In 1992, after a delay of approximately five years, the Tribe finally initiated suit, on its own, to quiet title to the Lake. Although the Tribe could have initiated suit in Idaho state court, it chose to bring the action in federal

court. Predictably, Idaho claimed immunity from suit under the Eleventh Amendment of the United States Constitution, and the case was ultimately dismissed by United States District Court Judge Harold Ryan.²

D. Idaho v. United States, 522 U.S. 262 (2001)

In 1994, the United States, as Trustee for the Tribe, commenced, for the first time, federal proceedings against Idaho to quiet title to that portion of the Lake located within the Reservation boundaries.³ This action, which itself spanned approximately seven years, culminated in a narrow decision in 2001 in favor of the Tribe's claim of ownership. Even then, however, four Supreme Court Justices, including Chief Justice Rhenquist, concluded that the "decisions of this Court going back more than 150 years establish [Idaho's ownership of the Lake] beyond a shadow of a doubt." Nonetheless, by virtue of the majority opinion, the Supreme Court's 2001 decision established that the United States' holds, in trust for the Tribe, that portion of the Lake located within the Reservation boundaries (representing approximately the lower 1/3 of the Lake).

E. The Tribe's Claim of Trespass and Related Claims

In addition to establishing the Tribe's claim of ownership, the Supreme Court's 2001 decision provided a foundation for the Tribe's current claims against Avista. Briefly stated, the Tribe claims the following:⁴

- (1) By virtue of the United States Supreme Court's decision in *Idaho v. United States*, the Tribe is, and has always been, the lawful owner of that portion of the Lake located within its Reservation boundaries;

² Notably, United States District Court Judge Harold Ryan concluded that the State of Idaho "has been in rightful possession of all of the lands and waters at issue in this case since it entered the Union in 1890. . .". Nonetheless, because the case was dismissed on Eleventh Amendment grounds, Judge Ryan's statements regarding ownership of the Lake were neither binding nor precedential.

³ The reservation boundaries represent approximately the lower 1/3 of the Lake. Although the Tribe has, since the early 1970's, claimed ownership of the entire Lake, the United States has not agreed to take action to quiet title to the upper portion of the Lake.

⁴ The first three of these claims would proceed in Federal District Court, while the fourth and fifth claims would be decided before FERC. At the present time, none of these claims have been formally advanced in litigation. Rather, the parties agreed to mediate the dispute prior to commencing litigation.

- (2) Between 1907 and 1981, Avista intentionally stored water on the Lake without approval or authorization from the Tribe and, in doing so, trespassed on Tribal lands;
- (3) As a result of Avista's trespass between 1907 and 1981, the Tribe is entitled to trespass damages, together with prejudgment interest thereon;
- (4) From 1981 (when the Post Falls HED was licensed under the FPA) to the present, Avista has stored water on the same Tribal lands without providing reasonable compensation to the Tribe as required under §10(e) of the FPA, which specifies that licensees whose projects occupy federal reservations must pay reasonable annual charges for their use;
- (5) Consequently, in addition to trespass damages and prejudgment interest for the 1907-1981 time period, the Tribe claims it is entitled to reasonable §10(e) compensation for Avista's use of its lands between 1981 and the present, together with prejudgment interest, along with such compensation during the term of any new license granted to Avista covering the Post Falls HED.

F. Mediation Process

In recognition of the significance of the issues at stake, as well as the likely costs and risks associated with litigation, Avista and the Tribe agreed to a mediation process prior to the Tribe's commencement of proceedings in Federal District Court and before FERC. The process agreed upon was unique, involving a blend of traditional litigation elements and mediated settlement negotiations. To oversee and facilitate settlement discussions between the parties, John Bickerman, a Washington D.C. mediator, was retained by the parties. In addition, the Honorable Judge William Canby of the United States Court of Appeals for the Ninth Circuit—a nationally renowned expert in the area of Indian law—was appointed to participate in the process to provide the parties with non-binding advisory opinions on the issues of liability and damages.

The mediation process lasted several years. It involved the collection, exchange and detailed analysis of more than 20,000 pages of historical records and documents;

required extensive reports from numerous experts; resulted in the submission of hundreds of pages of briefing and legal analysis before Judge Canby; and incorporated numerous meetings and negotiations between the parties. Those efforts culminated in a negotiated settlement that comprehensively addresses and resolves the Tribe's claims of trespass and §10(e) charges, together with many of the issues pertaining to Avista's pending application for a new FERC license for the Post Falls HED.

II. THE CASE FOR TRESPASS AND §10(e) LIABILITY

As noted above, the Tribe's claims, both as to the 1907-1981 and the 1981-present time periods, are premised on the theory that the Tribe is, and has always been, the owner of that portion of the Lake located within its Reservation boundaries, and that, as a consequence, it is entitled to damages and reasonable compensation for Avista's use thereof. In response, Avista has contended that historical evidence, read in conjunction with applicable law, can lead to the following conclusions:

- (1) Avista's use of the Lake as a reservoir was authorized by the Tribe's grant to Frederick Post, thereby precluding the Tribe's claim of trespass;
- (2) Avista's use of the Lake as a reservoir was further authorized by the United State's issuance of the 1909 Permit, which was properly granted by DOI and for which the United States received all compensation it requested;
- (3) The Tribe's claim of trespass is barred by the principles of acquiescence, impracticability, and impossibility;
- (4) The Tribe has failed to preserve its trespass claim under 28 U.S.C. §2415, such that it is now barred by the applicable limitations period. Alternatively, the Tribe has failed to preserve its claim of trespass for the years 1966-1981 and is, therefore, precluded from obtaining damages for Avista's use of the Lake for at least that time period;

- (5) The Tribe is not entitled to reasonable annual charges under §10(e) because Avista already possesses the right to use tribal submerged lands for hydroelectric purposes; and
- (6) The 1909 Permit bars any assessment of §10(e) annual charges by FERC for Avista's use of the Lake as a reservoir.

After extensive briefing by the parties, the Honorable Judge William Canby provided a non-binding advisory opinion addressing the issue of Avista's potential liability to the Tribe. [REDACTED]

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Dockets UE-080416 & UG-080417

III. POTENTIAL EXPOSURE

A. The Tribe's Damage and Reasonable Annual Charges Claim

With respect to the Tribe's claim for trespass damages and reasonable annual charges under §10(e), the parties agreed that, for purposes of the mediation process, the "Shared Net Benefits" ("SNB") methodology is the appropriate measure of damages. However, the parties disputed the proper application and effect of that methodology.

Briefly stated, the SNB methodology attempts to compare the cost of operating a hydroelectric project with the cost of the next-best alternative, thereby arriving at an incremental "net benefit." The SNB methodology then seeks to allocate those "net

benefits" among the affected parties, thereby narrowing in on the specific "net benefit" attributable to use of the Tribe's lands. As explained by the Ninth Circuit in *United States v. Pend Oreille PUD*, 135 F.3d 602 (9th Cir. 1998), the steps of the SNB analysis are as follows:

- (1) *Cost of operations.* This step determines the actual cost of owning, operating, and maintaining a hydropower plant;
- (2) *Alternative costs.* This step determines what it would cost to generate the same amount of electric energy from a different source, for example, from the least-cost alternative generating plant that could have been constructed in the place of the hydropower project;
- (3) *Net benefits.* These are calculated by subtracting the actual cost of the hydropower plant from the estimated cost of the alternative. This "net benefits" figure is the "power site value" of the project; and
- (4) *Allocation.* In this further step, the net benefits are allocated, or shared, between the operator of the project and the owners of the land. "Traditionally, net benefits are first divided equally between the landowners and project developers and then, in a second step, the landowner share is apportioned among the various individual landholders on the basis of the percentage of total project lands owned by each. The end result of the calculation must be an annual charge "reasonable" under §10(e).

In applying the SNB methodology to the present case, the Tribe's claim for its share of net benefits from generation at the Post Falls HED and related downstream facilities between 1907 and the present is substantial (even without consideration for pre-judgment interest).

B. Pre-Judgment Interest Claim

In addition to trespass damages and §10(e) annual charges, the Tribe also contended that it is entitled to compound prejudgment interest on all damages/charges

from 1907 to the present. Although not specifically set forth by the Tribe, using the Tribe's proposals for computing such interest, the Tribe's prejudgment interest claim exponentially increases its total claim for damages for the time period 1907 – present.

In response to the Tribe's claim for prejudgment interest, Avista argued that the Tribe's claim ignores the historical facts, which demonstrate that Avista is, at worst, an innocent trespasser on Tribal lands, and that the lengthy delay in achieving resolution of the Lake ownership issue was not attributable to Avista, but rather to the United States. In this regard, Avista has contended that between 1907 and 1972, Idaho exercised exclusive and unchallenged ownership of the Lake, during which time neither the Tribe nor the United States as its Trustee claimed an ownership interest in the Lake. Likewise, between 1972--when the Tribe first identified its ownership claim--and the present, Avista was powerless to facilitate resolution of the issue by virtue of the sovereign immunity of the United States, the Tribe, and Idaho. Accordingly, the earliest that prejudgment interest could begin to accrue is 2001, when a divided Supreme Court finally determined that the Tribe had an ownership interest in the Lake, and by extension a claim for trespass and §10(e) charges against Avista. To the extent that the Tribe has a claim for prejudgment interest prior to that time, its claim is solely and exclusively against the United States for breach of its trust obligations.

C. Potential Exposure for Damage and Pre-Judgment Interest Claims

Based on the Tribe's claims, Avista's total potential exposure to the Tribe is significant, even without including any liability Avista would have for reasonable annual charges under §10(e) during any new license issued to Avista covering the Post Falls HED.

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These negotiations continued for a number of months and culminated in a settlement resolving the Tribe's past, present and future claims regarding Avista's storage of water on that portion of the Lake located within the Reservation boundaries, as well as many of the issues pertaining to Avista's pending application with FERC to relicense the Post Falls HED.

IV. TERMS OF SETTLEMENT

1. Compensation for Trespass

The settlement provides for compensation to the Tribe for trespass damages, §10(e) charges and prejudgment interest as follows:

- Past Trespass and Past §10(e) Damages
 - Year 1: \$25 million
 - Year 2: \$10 million
 - Year 3: \$4 million
- Future 10(e) Payments⁵
 - Years 1-20: \$400,000 each year
 - Years 21-50: \$700,000 each year

2. Defense and Indemnity

As part of the Settlement, the Tribe agrees to indemnify, defend and hold Avista harmless from any and all liability, judgment, loss, cost and expense resulting from any and all claims of any kind or nature that may be asserted against Avista by the United States, or any governmental department, agency or officer thereof, arising out of, or related to or in any way connected with the use or occupancy by Avista of the bed and banks of the Lake and the St. Joe River lying within the boundaries of the Reservation.

3. Rights of Way

In consideration for an additional payment of \$32,000, the Tribe will grant Avista transmission line rights of way on tribal trust and fee lands for a term that corresponds with Avista's new FERC license.

⁵ There is no dispute that, to the extent Avista stores water on the Lake in the future as part of its operation of the Post Falls HED, it would owe reasonable annual charges under §10(e). This portion of the settlement provides certainty as to the amount of those charges.

V. FAVORABLE ASPECTS OF SETTLEMENT

The negotiated terms of the parties' settlement presents a favorable resolution to Avista of contested matters, particularly taking into account the following:

- 1) The settlement presents a full and final resolution of the Tribe's claim to trespass and §10(e) annual charges regarding Avista's use of the Lake as a reservoir from 1907 to the present and through the term of a new FERC license for the Post Falls HED. As such, the settlement presents a full and final resolution of disputed issues regarding more than 100 years of hydroelectric generation by Avista utilizing Tribal lands, as well as up to 50 years in the future;
- 2) The settlement eliminates Avista's potential exposure to a significant verdict for its historical use of that portion of the Lake located within the Reservation;
- 3) The settlement also resolves a number of critical issues pertaining to Avista's application with FERC to relicense the Post Falls HED, including the imposition of conditions under §4(e). The dispute between Avista and the Tribe over §4(e) conditions has been lengthy, involved, and contentious, resulting in protracted and expensive regulatory and legal proceedings; and
- 4) Finally, the settlement provides for water rights, rights-of-way and other authorizations necessary from the Tribe. In this respect, the settlement provides certainty to Avista.

The settlement does not give either party all the outcomes that might be obtained or desired under various scenarios, including the possibility of successful litigation in federal court. However, this must be weighed against the likelihood that formal litigation could last decades, could potentially subject Avista to an excessive amount in past damages; and could render future operation of the Post Falls HED impracticable. Therefore, considering the risks of litigation, together with the potential exposure and other considerations involved, the settlement reflects a reasonable compromise, and a fair accommodation, to the interests of Avista and its customers.