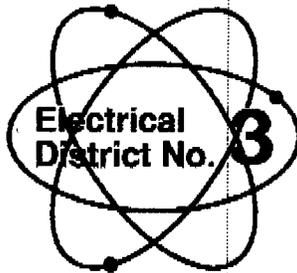


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October 27, 2004

FAX ((602) 352-2520) and MAIL

J. Tyler Carlson  
 Regional Manager  
 Western Arca Power Administration  
 Desert Southwest Region  
 P. O. Box 6457  
 Phoenix, AZ 85005-6457

Dear Mr. Carlson

This letter is intended to respond to the letter of September 27, 2004 from the Assistant Regional Manager for Power Marketing, Desert Southwest Customer Service Region, Western Arca Power Administration, stating that if no further comments were received, Parker-Davis Project Firm Electric Service Contract Extension Amendments would be offered in executable form within 30 days. The Assistant Regional Manager's letter further stated that previous customer comments to Western indicated that a dialogue between Western and its Parker-Davis Customers has resulted in workable language for Section 12, the section dealing with Western's unilateral right to determine whether to terminate a customer's contract or adjust its allocation of Parker-Davis power based upon certain unspecified events and determinations.

We have stated our deep concerns with the position espoused by the Assistant Regional Manager for Power Marketing to you and to Western's Administrator in correspondence dated August 23 2004, September 14, 2004 and October 15, 2004 and in our meeting with you and Western's Administrator October 18, 2004. We reiterate our concerns here and our opposition to Western proceeding to confront customers with executable Parker-Davis contract extensions until customers know much more about the contents of the extensions and certain provisions are removed from the extensions.

- A. Western's Proposed Unilateral Right to Terminate the Parker-Davis Contract and Adjust the Parker-Davis Power Allocation Should Be Deleted from the Contract Extension

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Western seeks the unprecedented and extraordinary authority to unilaterally determine whether a customer has "abrogated" its preference status or changed its "status ... in a manner that results in a change in the beneficiaries of the preference allocation ..." and, if so, to terminate the customer's contract or adjust its power allocation. The most current version of this language was circulated as an attachment to the Assistant Regional Manager for Power Marketing's letter of September 27, 2004 and intended to comprise a new Section 12 of the Parker-Davis contracts, entitled "Review and Adjustment of Federal Power Allocation."

The new Section 12 contains no criteria or standards to describe or limit the Administrator's exercise of discretion. There is no definition or criteria to indicate what "abrogation" of preference status means in Section 12.1, however, the customer must agree in advance that once the Administrator finds it has occurred, the Administrator can terminate the customer's contract. There are also no criteria or standards in Section 12.2 to limit what could constitute a change in status "in a manner that results in a change in the beneficiaries of the preference allocation" because the list of possible changes in status is only an "including, but not limited to" list of examples. Nevertheless, the customer would be required to agree that once the Administrator makes such a determination, the Administrator could unilaterally adjust the customer's allocation of Parker-Davis power.

When asked on October 18 why Western is proposing to its customers that they give Western this unprecedented authority to unilaterally terminate contracts and alter power allocations, Western responded that it doubted it had such authority under current law or that it could depend on courts to enforce its exercise of the authority if it had it. Western is, therefore, seeking the authority from its customers by proposing that they agree Western can unilaterally exercise the termination and allocation adjustment of Parker-Davis power. Western's proposal is wrong for several reasons.

First, Western has more than adequate authority to enforce the Reclamation Laws, including preference power resale limitations. Our counsel has advised us that this was amply demonstrated when the federal government successfully sued to enjoin the City of San Francisco from allowing Pacific Gas and Electric Company to benefit from preference power granted the City under the Raker Act of December 19, 1913 (one of the nation's first preference laws), instead of the City distributing Raker Act power directly to its citizens. *United States v. City and County of San Francisco*, 310 U.S. 16 (1940).

Western advised us on October 18 that it has confronted only two instances of changes in customer status which have led it to be concerned about changes in status under Reclamation Law. One occurred in Arizona and the other in Montana. Western also advised us that it believes both instances have been resolved satisfactorily. Western obviously took whatever action it deemed necessary in those situations to resolve whatever Reclamation Law enforcement concerns it had. The successful resolution of those two instances of change

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in customer status under Western's existing enforcement authority demonstrate that Western is not justified in seeking unprecedented, unilateral authority to adjust power contract allocations from Parker-Davis customers.

Second, while we believe Western has more than adequate authority to carry out and enforce the Reclamation Laws, if Western believes it needs additional enforcement authority, Western should seek that authority from Congress, not from its customers. Congress enacted the Reclamation Laws. If Western were to try to acquire power to enforce the Reclamation Laws by requiring its customers to agree in advance to critical, unilateral determinations by Western, Western would deprive the customers of the right subsequently to challenge Western's unilateral determinations. At the very least, when combined with Western's broad discretionary authority under federal administrative law, requiring customers by contract to acquiesce in Western's unilateral decision-making in certain yet-to-be-revealed circumstances would create the negative implication that a customer could never meaningfully challenge the grounds upon which Western based a contract termination or power allocation adjustment decision. This would result in a serious diminution of existing customer rights.

Third, the legal underpinnings for the proposed Section 12 are substantially in doubt, as demonstrated by comments in a letter to Jean Gray this week by Robert S. Lynch, Esq., Counsel to Irrigation and Electrical Districts of Arizona.

Fourth, the addition of Section 12 to power contracts would invite opportunists – some would say “bounty hunters” – to exploit legitimate actions by customers over the life of their contracts to try to obtain Parker-Davis power. These opportunists could be expected to seek out Parker-Davis customers who might be considering legitimate business restructuring plans and threaten to harass them before Western unless such customers met their demands.

The kinds of restructuring of business relationships referred to in Western's “including but not limited to” list of possibly impermissible changes in status (such as engaging in a merger or joining or withdrawing from member-based power supply entities) are good examples of the kind of private business organization matters with which Western has no legitimate concern. If a customer acts in a manner which implicates the Reclamation Laws or its preference status under them, Western has a proven remedy to pursue with the customer, as the federal government did against the City of San Francisco. In short, the broad, unlimited powers Western seeks through Section 12 to meddle in customer affairs would constitute not only an open invitation to meddling by Western, but also an invitation to opportunists seeking short term gain to inject themselves and possibly Western into matters which are of no concern to Western. We see no practical reason why Western should invite itself into general oversight of matters under control of the customers and other regulatory agencies.

B. Western's Advance Funding Provisions For Parker-Davis Customers Should Remain

### Voluntary

Western appears to be proposing that its existing, successful Parker-Davis advance funding program be converted from a voluntary program to a mandatory one. We infer this could be Western's intention from the text of Western's 2003 "Notice of Decision" (68 Fed. Reg. 23709 at 23712 (2003)), wherein Western stated, "Western received no comments on this requirement, so advance funding will be included as a requirement in the contracts."<sup>1/</sup> If it is Western's intention to convert the current voluntary advance funding program into a mandatory one for current Parker-Davis customers, Western must withdraw the proposal for a number of reasons.

From a legal standpoint, Western never established the grounds for its purported decision in its 2003 *Federal Register* notice or in its earlier 2002 "Notice of Proposal" to justify making advance funding mandatory for *existing* Parker-Davis customers because it never addressed advance funding for *existing* customers – only for *new* customers. (See 67 *Federal Register* 51580 at 51581 (2002).) Moreover, Western excluded advance funding in its 2002 *Federal Register* notice from the list of acceptable subjects on which it would accept comments.<sup>2/</sup> Since Western never proposed to make advance funding for *existing* customers mandatory in the first place and since it disinvited comments on the subject of advance funding all together, Western has obviously not established the requisite basis in either its 2002 or its 2003 *Federal Register* notices to convert the current voluntary advance funding programs into a mandatory one for existing customers.

More importantly, from a policy standpoint, voluntary advance funding has worked well since 1996 as a customer supported vehicle to provide needed operation and maintenance funds for the Parker-Davis project. A large part of the success of advance funding is attributable to the outside oversight and accountability provided by the independent Funding Board, established in the currently effective Parker-Davis Advancement of Funds Contract. Any departure from the voluntary nature of the current advance funding program would threaten the integrity of the program and the independence of the oversight accorded it by the Funding Board.

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<sup>1/</sup> "The requirement to advance fund will be included in the Parker-Davis Project firm electric service contract as a condition for receiving an allocation of P-DP power." See Western's Answer to Question 9, "Frequently Asked Questions," (September 2003, <http://www.wapa.gov/dsw/pwrmt/PDPremarktAQ.pdf>)

<sup>2/</sup> Western limited permissible subjects of comment by stating that it was "...seeking comments regarding [1] the applicability of the PMI to P-Document preparation, [2] the percentage of resources to be extended to existing customers, and [3] the size of the proposed resource pool." Advance funding was not included in the forgoing list of subjects on which Western invited comments.

If Western intends to change the scope of the existing advance funding program, it should discuss and justify adjustments to the program well before customers are presented with final contract extensions. The current version of the Parker-Davis contract extension, "PROTOTYPE Revised 3/31/04," barely contains a reference to advance funding.<sup>3/</sup> Therefore, it is obvious that Western must engage in much more detailed discussion with its customers than it has to date before it can ever expect them to be in a position to agree to any significant changes in the current advance funding program.

Finally, Western needs to carefully and in detail address how it will implement advance funding for new Parker-Davis customers and to ensure that commensurate credits are given to current customers for having over-funded their now reduced share of post 2008 Parker-Davis power output. Had Western simply shrunk the pool of Parker-Davis power available to existing customers and turned that reduced amount of power over to new customers (as envisioned might happen in the AOF Agreement), the issue of proper catch-up payments from new customers and credits to existing customers would have been relatively simple. However, Western did not do this in remarketing Parker-Davis power.

Western determined that there was more Parker-Davis power for marketing after 2008 than there had been before 2008 due to efficiency improvements from rewinding the generating units. In other words, Western decided simultaneously to shrink the Parker-Davis power allocations available to existing customers and grow the total amount of Parker-Davis power to be allocated, raising possible inter-customer equity concerns. This means that existing customers wound up with much less of a net reduction in their allocations than they might have otherwise expected, while new customers still received a significant amount of power. While this is beneficial to all Parker-Davis power customers, Western needs to be careful in how it calculates the amount of catch-up payment due to be collected from new customers and due to be credited to existing customers. Otherwise, Western could shortchange some customers who advanced the funding of the generator upgrades. For this reason, Western must spell out its processes in detail.

C. Western Should Not Proceed With Contract Extensions Until Customers Are Provided With More Details Regarding the Contents of Their Contract Extensions

While Western has no doubt engaged in detailed negotiations over the terms of Western's extension of Parker-Davis contracts with some of its customers, we have not yet had the benefit of any such negotiations. Nevertheless, the Assistant Regional Manager for

<sup>3/</sup> Section 6.2, the only reference in the document to any kind of advance funding, appears to envision a voluntary advance funding program by proposing that "The Parties may also provide for payment in advance of service by such other means as may be mutually agreed to in writing by the Parties."

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Power Marketing's letter of September 27, 2004 states that "executable contracts" could be presented to customers within 30 days of that letter and be required to be returned within another 60 days.

The September 27<sup>th</sup> submittal only included language from a single section of the entire Contract Amendment, and it did not provide a complete draft of the entire Amendment so the customers could read such Amendment in its entirety and provide comments related thereto. The implication is that the other sections of the Amendment are all decided, or unchanged from previous drafts submitted by Western. Yet as we discovered in individual meetings with other customers, many of Western's customers have had separate discussions with Western's staff on numerous provisions of the Amendment and they are at best uncertain of the latest language of the entire Amendment. Therefore, the implication that the Amendment would be ready for execution is hardly compatible with the fact Western has not provided a complete draft of the entire Amendment for all customers to review. This omission leaves many customers confused as to what the latest language is since there have been so many individual meetings, discussions, and emails circulating in the region over the past several months.

Given the large number of important issues which may remain outstanding between Western and its customers, Western must not under any circumstances confront customers prematurely with the decision of whether or not to extend their Parker-Davis contracts. Instead, Western must work with customers until they reach a much better understanding of the latest draft of the entire Amendment's terms and conditions for extending current Parker-Davis contracts.

\* \* \*

We appreciate this opportunity to comment and look forward to working with you further to develop appropriate language to extend the Parker-Davis Firm Electric Service Contracts.

Sincerely,



Grant R. Ward  
General Manager

cc: Mr. Michael Hacskaylo, Administrator  
Western Area Power Administration