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E-MAILED AND MAILED

October 27, 2004

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Re: Comments on the September 27, 2004 proposed version of Section 12 of the Parker-Davis Project Firm Electric Service Contract extension amendment entitled "Review and Adjustment of Federal Power Allocation", forwarded with your memorandum of September 27, 2004

Dear Jean:

In my comments to you of August 13, 2004 on the prior version of this proposed Section 12, I indicated that I had a continuing concern about the extent to which the language in the proposed Section 12, especially subsection 12.1, was not supported by Reclamation law. I indicated to you at the time that I was attempting to complete research on the issue and would send you additional comments when I had done so. I believe I am now at a point where I can comfortably explain to you why I believe Reclamation law does not support the operative provisions of the proposed Section 12. Additionally, I believe that Western's own regulations run contrary to these provisions.

Given the long history of discussions between Western and its customers over this provision, I think it is important that we focus on the law related to this provision because of the possibility that a court might construe any such provision in ways we cannot imagine in the future. The poster child for that result is, of course, the Ninth Circuit decision in O'Neill v. United States, 50 F.3d 677 (9th Cir. 1995), cert. denied, 516 U.S. 1028 (1995). In that case, the Court found that the simple phrase "or any other cause" at the end of the "force majeure" section of a water contract forced the Bureau the Reclamation to take roughly half of the Central Valley Project water supply intended for the Westlands Water District under the contract in question because the Endangered Species Act was an "other cause". If that result can come from common "boilerplate", new language poses even greater risk of such court-driven unintended consequences. Since the proposed Section 12 constitutes a substantial departure from existing contractual requirements, a careful examination of the law related to it seems in order.

1. Reclamation law does not require that preference status be maintained during the life of a contract nor authorize Western to make unilateral changes in a contract should such status change during its term.

Much concern has been expressed about the provision in subsection 12.1. Much of that concern relates to what is perceived as unfettered discretion on behalf of the Administrator to take away a contractor's allocation on the basis of a change in preference status during the term of the contract. However, application of the preference law is not a matter of discretion, it is a matter of law. In all instances, contract action taken by a federal official invoking the preference clause requirement is judicially reviewable. Brazos Electric Power Cooperative, Inc. v. Southwestern Power Administration, et al., 819 F.2d 537, 544 (5th Cir. 1987); City of Santa Clara v. Andrus, 572 F.2d 660, 669 (9th Cir. 1978), cert. denied 439 U.S. 859; Arizona Power Pooling Association v. Morton, 527 F.2d 721, 727-8 (9th Cir. 1975), cert. denied sub nom. Arizona Public Service Co. v. Arizona Power Pooling Association, 425 U.S. 911 (1976).¹ Thus, any decision by the Administrator invoking this subsection would be judicially reviewable if the law required that preference status be maintained during the life of the contract.

The problem is that Reclamation law does not require that preference be maintained during the life of the contract nor is there any other authority for requiring this conduct on behalf of a contractor.

Western was established on December 21, 1977, pursuant to Section 302 of the Department of Energy Organization Act, P.L. 95-91. The Bureau of Reclamation's power marketing authorities were transferred to Western pursuant to Section 302(E) of the Act. Additionally, the Secretary of Energy was granted general contract authority in Section 646 of the Act (42 U.S.C. Section 7151). The Department of Energy Organization Act did not amend Reclamation law. See: Colorado River Energy Distributors Association v. Lewis, 516 F.Supp. 926, 929 (D.D.C. 1981); see also: United States v. Tex-La Electric Cooperative, Inc., 693 F.2d 392 (5th Cir. 1982). Thus, Western must take Reclamation law as it finds it.

The central issue concerning subsection 12.1 is whether Western has an obligation to ensure that an entity qualified for preference that receives an allocation and contract for federal hydropower maintains that preference status during the entire length of the contract. Western has no such obligation.

¹ Attempted application of the preference law to unilaterally amend or cancel a power contract is thus distinguishable from federal discretionary decisions concerning allocations among preference entities, which the courts have declared nonreviewable. City of Santa Clara v. Andrus, 572 F.2d 660, 668 (9th Cir. 1978), cert. denied sub nom. Pacific Gas and Electric Co. v. City of Santa Clara, 439 U.S. 859; Arizona Power Authority v. Morton, 549 F.2d 1231, 1241, 1252 (9th Cir. 1975), cert. denied, 425 U.S. 911 (1976).

No case of which I am aware has directly addressed this issue with regard to Section 9(c) of the Reclamation Project Act of 1939. However, that preference provision and others, such as the one in Section 5 of the Flood Control Act of 1944, must be read *in pari materia*. Solicitor Melich opinion, M-36812, 77 I.D. 141 (1970); Solicitor Weinberg opinion, M-36769, 75 I.D. 403 (1968); 41 Op. Atty. Gen. 236, 245 (1955). See also: City of Santa Clara v. Andrus, 572 F.2d 660, 668 (9th Cir. 1978), cert denied sub nom. Pacific Gas and Electric Co. v. City of Santa Clara, 439 U.S. 859. Thus, cases involving other preference clauses such as the one in Section 5 of the Flood Control Act are relevant.

The lone case I have been able to find on this subject is Arkansas Power & Light Company v. Schlesinger, an unreported decision in 1980 by the District Court for the District of Columbia. In that case, the Court held that Section 5 of the Flood Control Act did not give the government authority to unilaterally alter existing contracts. Specifically as to the preference provision of Section 5, the Court held (1) that determination of compliance with the statutory preference requirement should be made at the time the contract is executed and (2) that the preference provision is not intended to permit subsequent revision of power contracts, citing City of Anaheim v. Kleppe, 590 F.2d 285 (9th Cir. 1978) and City of Santa Clara v. Andrus, *supra*.

Were the above decision a reported decision, then clearly it would be assumed by everyone to be controlling precedent as the only case directly on the subject. Even though unreported, in this instance it is that controlling precedent. The reasons are simple. The case is cited as authority in the Department of the Interior's treatise on the subject: Federal Reclamation Law and Related Laws Annotated, Supplement I, page S151. A foreword to that volume notes that case decisions are inserted that interpret laws and are deemed relevant to the programs and activities of the Bureau of Reclamation or the Power Administrations. *Id.*, Foreword, page v. Even more importantly, the Arkansas Power & Light case has been cited as authority by no less than three reported cases: Colorado River Energy Distributors Association v. Lewis, *supra*, 516 F.Supp. at 132; United States v. Tex-La Electric Cooperative, Inc., 524 F.Supp. 409, 415-418 (E.D. La. 1981), reversed on other grounds, 693 F.2d 392 (5th Cir. 1982); City of Fulton v. United States, 680 F.2d 115, 122, n.28 (Ct. Cl. 1982), affirmed, 751 F.2d 1255 (Fed.Cir. 1985), rev'd. on other grounds sub nom. United States v. City of Fulton, et al., 475 U.S. 657 (1986). Under these circumstances, the Arkansas Power & Light case is controlling law. There is no authority to reopen a contract for changes in the preference status of a preference contractor for federal hydropower.

2. Reclamation law does not otherwise empower Western to unilaterally reopen power contracts because of a change in preference status of the power contractor.

Western has assumed the power marketing functions granted to the Secretary of the Interior by Section 9(c) of the Reclamation Project Act of 1939. Other than the preference clause, which provides no authority for unilateral reopening of power contracts, there is no other provision in Section 9(c) or otherwise in Reclamation law that provides such authority. It is true that the power to contract carries with it generally the authority to set terms and conditions of contracts.

Sierra Club v. Andrus, supra.; Colorado River Energy Distributors Association v. Lewis, supra. However, as a federal agency, Western is a creature of statute having no constitutional or common law existence or authority, but only those authorities conferred on it by Congress. California Independent System Operator Corporation v. Federal Energy Regulatory Commission, 372 F.3d 395, 398 (D.C. Cir. 2004). It is therefore incumbent upon Western to demonstrate that some statute confers upon it the power it purports to exercise, in this case the power to unilaterally reopen a power contract based on a change in preference status of the power contractor. Id. See also: Williams Gas Processing, et al. v. Federal Energy Regulatory Commission, 373 F.3d 1335 (C.A.D.C. 2004). Since FERC, as successor to the Federal Power Commission, has no implied authority granted it under the Department of Energy Organization Act to direct the business practices of jurisdictional entities, it is fair to assume that Congress did not intend that this newly created power marketing administration, the Western Area Power Administration, have such a sweeping new authority in that Act by implication. As the above discussion of case law with regard to the preference clause shows, it provides no such sweeping authority and Western acquired no new authorities not already in place when it was created.

3. The lack of expressed statutory authority also taints the proposal in subsection 12.2 to reexamine and reopen contracts unilaterally if a power contractor's business status changes.

The obvious reason for this provision being proposed is two prior experiences Western has had when distribution co-ops rearranged themselves and wanted to retain aliquot shares of the preference allocation and contract held by the G&T. Mike HacsKaylo has recently stated that the reason for this provision is to "preserve the integrity of Western's marketing plans." Letters of October 19, 2004 to attendees at the meeting of October 18, 2004. Regardless of the motive, it is difficult to find legal authority for, in effect, regulating the business practices of power contractors.

This proposal is even more closely analogous to the situation confronted by the courts in the Cal ISO and Williams Gas Processing cases. Unlike those cases, however, the direct mandatory authority for Western's marketing plans stems from a command to sell surplus power from federal projects and to apply the statutory preference in doing so, all embodied in Section 9(c) of the Reclamation Project Act of 1939. There is nothing in the statute nor, just as importantly, nothing in the existing marketing criteria, that supports reexamining an allocation and contract once put in place. Absent that, since the allocations are made and the contracts are entered into on the basis of contractor load, there is no rationale for a federal interest in which consumers are receiving the benefit of that load as long as the preference contractor is providing the benefit of the preference power to its consumers. To act otherwise would be to, in effect, make the allocation to the subsidiary organizations. Where that is not the case, the legitimate government interest is only in ensuring that consumers continue to benefit from the allocation.

Likewise, where organizations band together having already received an allocation and contract, there is no legitimate federal interest in reexamining those allocations and contracts

if these organizations were to act in concert in some combination or under some set of agreements or statutes.

In either case, the overriding fact of consumers receiving the benefit of federal hydropower renders any inquiry into the question of which consumers void of legitimate federal interest. Nor can the agency rely on the concept of providing preference power for the widest possible use consistent with sound business principles (a phrase taken from Section 5 of the Flood Control Act of 1944). Every court that has examined that phrase has rendered it vague beyond analysis. See: Salt Lake City, et al. v. Western Area Power Administration, 926 F.2d 974, 979-980 (10th Cir. 1991); City of Santa Clara v. Andrus, *supra*. There are no criteria that could be established under that concept and thus no legitimacy to it in terms of contractual obligations.

4. The operative provisions of Section 12 violate Western's Energy Planning and Management Program (EPAMP) regulations.

The EPAMP regulations are codified at 10 C.F.R. Part 905. They were adopted in 1995 in part to implement Section 114 of the Energy Policy Act of 1992. 60 Fed.Reg. 54151, *et seq.*

Subpart C of the regulations contains the Power Marketing Initiative (PMI). Therein, Western decided to provide contract extensions as an integral part of its conservation program. 50 C.F.R. Section 905.30. Existing customers will get contract extensions for percentages of existing allocations based on a specific formula. 10 C.F.R. Section 905.33.

The only qualification in the existing allocations other than the percentage formula is as follows:

“905.34 Adjustment Provisions.

Western reserves the right to adjust marketable resources committed to all customers with long-term firm power contracts only as required to respond to changes in hydrology and river operations, except as otherwise expressly provided in these regulations. Under contracts that extend resources under this PMI, existing customers shall be given at least 5 years' notice before adjustments are made. New customers may receive less notice. The earliest that any notice under this section shall become effective is the date that existing contractual commitments expire. Any adjustment shall only take place after an appropriate public process. Withdrawals to serve project use and other purposes provided for by contract shall continue to take place based on existing contract/marketing criteria principles.” (Emphasis supplied.)

Western's decision of May 5, 2003 was to apply the PMI portion of its EPAMP regulations to the Parker-Davis Project. 68 Fed.Reg. 23709, *et seq.* These regulations in no place reference changes in preference status (12.1) or changes in status by reason of merger, etc. (12.2). Nor

do the existing marketing criteria and allocation decisions cited in the May 5, 2003 decision. These criteria and plan decisions are incorporated by reference in the EPAMP regulations. 10 C.F.R. Section 905.36.

Since the operative regulation limits allocation adjustments and doesn't include the two reasons stated in proposed Section 12, these additional reasons are outside the scope of existing Western regulations and without legal authority to implement.

In short, the operative provisions of Section 12 have no direct legitimate statutory basis and are contrary to existing regulations. Western should eliminate the proposed Section 12 from the draft Parker-Davis contract.

Sincerely,
ROBERT S. LYNCH & ASSOCIATES



Robert S. Lynch

RSL:psr

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