ISSUES REMANDED TO BONNEVILLE POWER ADMINISTRATION IN PACIFIC NORTHWEST GENERATING COOPERATIVE V. DEPARTMENT OF ENERGY (*PNGC I*), 580 F.3D 792 (9TH CIR. 2009) AND PACIFIC NORTHWEST GENERATING COOPERATIVE V. BONNEVILLE POWER ADMINISTRATION (*PNGC II*), 596 F.3D 1065 (9TH CIR. 2010)

ADMINISTRATOR'S RECORD OF DECISION

February 18, 2011

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I. INTRODUCTION

This final record of decision (ROD) addresses issues remanded to Bonneville Power Administration (BPA) by the United States Court of Appeals for the Ninth Circuit (the court or Ninth Circuit) in *Pacific Northwest Generating Cooperative v. Department of Energy (PNGC I)*, 550 F.3d 846 (9th Cir. 2008), *amended on denial of reh'g*, 580 F.3d 792 (9th Cir. 2009), and *Pacific Northwest Generating Cooperative v. Bonneville Power Administration (PNGC II)*, 580 F.3d 828 (9th Cir. 2009), *amended on denial of reh'g*, 596 F.3d 1065 (9th Cir. 2010). In *PNGC I*, certain parties challenged BPA's FY 2007 – 2011 direct service industrial customer (DSI) service construct and contracts (2007 Block Contracts or Block Contracts). *PNGC II* involved the challenge to an amendatory agreement to the Block Contract by and between BPA and DSI customer Alcoa Inc.

On June 22, 2010, BPA released for public comment a draft record of decision (DROD) addressing the threshold legal issues identified in the court's remand order, as well as other issues set forth in the DROD. Initial written comments from interested parties on BPA's DROD were filed on July 23, 2010. Between July 26, 2010, and August 9, 2010, BPA invited cross-comments from parties to respond to specific issues addressed by parties in their initial comments. Parties filing comments were Clallam Public Utility District (Clallam), Public Power Council (PPC), Pacific Northwest Generating Cooperative (PNGC), Pacific Northwest Investor-Owned Utilities (IOUs), Port Townsend Paper Corporation (Port Townsend), Alcoa Inc. (Alcoa), Northwest Requirements Utilities (NRU), and Industrial Customers of Northwest Utilities (ICNU).[1]

The remainder of this ROD is divided into four major sections. Section II outlines the Administrator's final decisions and briefly describes the rationale for these decisions. Section III provides background information on the *PNGC* cases and events leading up to this ROD.

The next two sections contain the legal analysis of the remand issues, as well as analysis of several issues raised in public comments. Section IV addresses issues related to the aluminum company transactions, separated into two time periods described in Table 1 below, and section V addresses the Port Townsend/Clallam transactions. Table 1 defines the three time periods analyzed in this ROD.

[1]Cross-comments are cited as "cx." *E.g.*, "PPCcx at 1." Each party filing comments, except Clallam, also filed cross-comments.

Tbl. 1. Lookback Time Periods

Time Period	Referred to as	Parties	ROD Section
October 2006 through November 2008	Initial Lookback Period	Alcoa CFAC	IV.A
January 1, 2009, through September 30, 2009	Amendment Lookback Period	Alcoa[2]	IV.B
October 2006 through September 2009	Port Townsend Lookback	Port Townsend Clallam County PUD	V.

II. OVERVIEW OF ADMINISTRATOR'S FINAL DECISIONS

This section summarizes the final decisions in this ROD, the bases for the individual decisions, and the major legal issues that have been raised and addressed in this remand proceeding.

A. BPA is contractually prohibited from seeking repayment from Alcoa and CFAC for any overpayments of monetary benefits during the Initial Lookback Period. Likewise, neither company is permitted to pursue claims for additional payments from BPA under the Block Contract. (*PNGC I* remand item)

1. The damage waiver provision is enforceable and BPA therefore has no claim to pursue against CFAC or Alcoa for the Initial Lookback Period.

BPA interprets the remand order as instructing BPA, in the first instance, to consider whether the damage waiver provisions in the 2007 Block Contracts with Alcoa and CFAC act as an enforceable prohibition against collection actions as a matter of law. Based on its interpretation of the Block Contracts, and applying relevant law, BPA has determined that the damage waiver is valid and enforceable, notwithstanding the arguments raised by preference customers that BPA is legally bound to seek recovery and that this duty may not be waived by contractual agreement. Thus, for the period of time during which the damage waiver provision was in effect, there is no claim to pursue.

[2] As discussed in section III, in January 2009, BPA, Alcoa, and Public Utility District No. 1 of Whatcom County, Washington, entered into Amendment No. 1 (Amendment) to the 2007 Block Contract, in an attempt to restructure and continue service to Alcoa in a manner consistent with the unamended *PNGC I* opinion. BPA entered into a substantially similar amendment with CFAC, but no party challenged the CFAC amendment and therefore it is not at issue in this remand. No amendment was entered into with Port Townsend following *PNGC I*, inasmuch as BPA believed it could, and in fact did, continue to sell physical power pursuant to the BPA/Clallam Contract, until such time as all petitions for rehearing were disposed of, and the mandate issued in that case. Therefore, Alcoa is the only counterparty for the Amendment Lookback Period.

In summary, this position finds support in the following factors:

a) The language of *PNGC I* suggests that the contracts are not void *ab initio* and that a finding that the provision is enforceable is reasonable. *PNGC I*, 580 F.3d at 827.

b) Consistent with BPA's interpretation of *PNGC I*, case law is clear that commercial contracts of the Federal Government should rarely be declared void *ab initio* even in cases involving legal error.

c) It is important, as a matter of sound business practice and insofar as it is legally permissible, for the Administrator to defend explicit terms of contracts that have been entered into in good faith and have been fully and faithfully performed. This policy is consistent with BPA's statutory authority to operate in a business-like manner.

d) The damage waiver provision is to the same effect as the general common law rule that parties are left in the position they were in at the time the illegality is discovered, not restored to the position they would have been in had the contract never been entered into. *See* 17A, Am. Jur. 2d, Contracts § 322 at 308 (2004); Restatement (Second) of Contracts § 197 (1981).

e) The Government has the ability to waive rights, or forebear in enforcement of rights, and to allocate potential future risk to itself through contractual terms. As noted by the IOUs in their comments in this remand proceeding, governmental entities commonly accept allocations of risk in their contracting relationships. *See, e.g.,* United States v. Winstar Corp., 518 U.S. 839, 907-08 ("[Government] contracts routinely include provisions shifting financial responsibility to the Government for events which might occur in the future.").

f) The Ninth Circuit has conclusively held the BPA Administrator is authorized to serve DSI load and to incur certain costs associated with such service.

g) Inasmuch as the BPA Fund constitutes a permanent and indefinite appropriation[3] available to the BPA Administrator to make expenditures in furtherance of, among other things, such DSI service, the payments made under the Block Contracts did not violate the Appropriations Clause of the United States Constitution even though the court found BPA committed legal error in implementing its authority to serve DSI load.

In sum, the Administrator finds that no enforceable claim against Alcoa or CFAC exists for the term covered by the damage waiver provision. Likewise, each company is

[3] "Permanent" meaning once made it is always available unless revoked and "indefinite" meaning that it is of an unspecified amount unless expressly restricted.

prohibited by the damage waiver from pursuing any claim against BPA for the term covered by the provision.

2. BPA's decision to not seek refunds from the DSIs is not inconsistent with BPA's separate decision to recover overpayments under the 2000 Residential Exchange Program Settlement Agreements.

Fundamental differences between the DSI Block Contracts and the 2000 Residential Exchange Program (REP) Settlement Agreements (REP Settlement Agreements) compel different outcomes. In the case of the REP Settlement Agreements, the court held that the agreements exceeded the scope of BPA's statutory authority. In reaching this conclusion, the court did not identify any provision in the REP Settlement Agreement that was severable from the agreement or that would be otherwise enforceable in light of the court's holding. This was not the case with the Block Contracts. As discussed repeatedly in this ROD, the *PNGC* court did not hold that the Block Contracts are entirely void, and affirmed BPA's statutory authority to make power sales to the DSIs. In addition, the record supports, and the *PNGC* cases countenance, a determination by BPA that it would have entered into transactions in 2006 with the DSIs using the correct rate, that such transactions would have been structured to provide service to the companies within the same economic parameters as the 2007 Block Contracts, and that this would have been found by BPA to be consistent with its long-term business interests. Therefore, unlike in the case of the REP Settlement Agreements, it is reasonable to conclude there were no overpayments to the DSIs that must be recovered.

B. BPA is not contractually prevented from seeking additional payments from Alcoa for the Amendment Lookback Period, but does not have a reasonable legal or equitable basis for doing so. (*PNGC II* remand item)

During the period when BPA service was being provided to Alcoa pursuant to the nine-month Amendment, neither party was protected by a damage waiver provision. PPC notes that, in the case challenging that Amendment, BPA stated in a brief that, due to the removal of the damage waiver provision in the Amendment, "there are no contractual barriers to compensatory or corrective relief in the ordinary course of this litigation to remedy Petitioners' alleged monetary injury."[4] While this is true, there has been no breach of contract or improper conduct on the part of Alcoa that contributed to the adverse findings in *PNGC II*. BPA and Alcoa negotiated, in good faith, an arrangement that would avoid a disruption in operations at Alcoa's Intalco plant, an arrangement that both parties desired. The parties had substantially performed their respective obligations under the Amendment at the time the court issued its finding that the Amendment was legally defective. Were the Amendment itself simply declared a nullity, the typical common law remedy, as noted above, would be to leave the parties as they were at the time the illegality was discovered, with no avenue for remedial relief of any kind. While BPA was not considering the matter in these precise terms at that time, the immediate

[4] PPC at 8 (citing BPA's Motion to Reconsider and Vacate Order Granting Petitioners' Motion to Expedite Proceedings and to Stay These Proceedings at 16, *PNGC II*, 596 F.3d 1065 (9th Cir. 2010) (No. 09-70228).

result was the same in that BPA did not make the final two payments under the Amendment upon the publication of the *PNGC II* opinion.

BPA also considered the fact that there seems to be a general reluctance on the part of the federal courts to declare a contract with the Government a nullity. At times, courts will use the doctrine of mutual mistake or will resort to reformation of contract to preserve the parties' bargain to the extent possible. Given the relatively brief term remaining on the Amendment, however, such an approach did not seem practical, especially considering that Alcoa and BPA were already working toward consummation of a contract based on a physical sale of power, the direction that appeared to be most sustainable in light of *PNGC II.*

None of these above-described approaches would fully deprive Alcoa of its bargain; nonetheless, that is the result that is being advocated by the preference customers. Their position is untenable. BPA has concluded that to achieve such a result, restitution would have to be sought through a quasi-contractual theory based on unjust enrichment. BPA posited in the DROD that such a claim might well be subject to a successful defense based on a theory of equitable estoppel. Alcoa has argued, both here and elsewhere, that it is the aggrieved party, and that if anything, it is owed additional payments by BPA. Alcoa maintains that it has not been unjustly enriched but rather has been unjustly deprived of contractual benefits. While BPA believes Alcoa's purported claim that it has been underpaid by almost $200 million is dubious and not supported by the *PNGC* cases, it is not at all clear under the circumstances of this case that Alcoa has been unjustly enriched. Moreover, while BPA understands the difficulties attendant in seeking to estop the Government, it must also be acknowledged that the Government has been estopped in the past, including in numerous cases before the Ninth Circuit, and the Supreme Court has expressly declined to hold that the Government may never be estopped.

In this instance, and as discussed at greater length herein, under the totality of the circumstances surrounding the development of the 2007 Block Contract, and the Amendment thereto, BPA believes that Alcoa would have a reasonably good chance of a) showing that it has not been unjustly enriched, and/or b) mounting a viable estoppel defense against any claim by BPA for recovery of money paid to Alcoa during the Amendment Lookback Period. Moreover, Alcoa would likely raise an affirmative claim against BPA, as Alcoa has described in it comments in this proceeding and in briefs filed with the court in the *PNGC* cases. The purpose of this ROD is not to exhaustively and definitively evaluate the merits of Alcoa's potential claim. But regardless of the relative merits of Alcoa's potential claim, BPA believes that initiating a bare equitable claim for restitution against Alcoa would not likely result in Alcoa repaying BPA a significant amount, if any, of the money it received under the Amendment, and would expose BPA to some risk of paying a judgment to Alcoa under its theory of underpayment.[5]

Finally, preference customers have argued in their comments that case law is clear that the United States has a claim, presumably both legal and equitable, for recovery of

[5] In addition, there is no certainty that the United States Department of Justice would file such litigation on BPA's behalf. DOJ, not BPA, is authorized to file litigation for BPA.

money disbursed any time it can be shown that such expenditures were erroneously made or based on a legal error of any kind. Moreover, preference customers seem to suggest all such errors violate the Appropriations Clause of the United States Constitution. While it is true that expenditures cannot be made in derogation of a congressional appropriation, the analysis is far more complex than apprehended by preference customers. The most glaring error in the preference customers' analysis regarding the Appropriations Clause is that they have essentially conflated the central holdings that the United States has a common-law right to seek recovery, for which no additional statutory authorization is required, with the notion that, in each and every such case of error, the United States possesses a valid and enforceable claim for which there could never be a valid defense. As shown more fully below, BPA disagrees with these conclusions.

C. BPA does not have a viable contract or equitable claim against either Clallam or Port Townsend. (*PNGC I* remand item)

The three way contractual arrangement, with Clallam PUD purchasing power from BPA for resale to Port Townsend, was a good faith transaction. Both the BPA-Clallam and Clallam-Port Townsend contracts were fully performed. Although BPA's contract with Clallam does not expressly prohibit recovery of additional payments, this is not contemplated within the contract. Therefore, BPA does not have a contractual claim against Clallam to recover any additional payments. Because BPA did not have a direct contractual relationship with Port Townsend, it has no contractual claim against Port Townsend.

With no contractual claim, BPA's other option would be to seek recovery based on some equitable theory. However, equitable considerations weigh against doing so. There was no overreaching in the transaction or any other conduct in the development of the contract that would provide a basis for considering Port Townsend to be anything other than a good faith purchaser for value under an express agreement covering the subject matter for which restitution would have to be sought. In such a situation, BPA believes that it would be highly unlikely that a court would find a basis for upsetting the reasonable expectations of the parties, as expressed in the written contracts, and supplanting that express agreement with a quasi-contractual remedy that would deprive Port Townsend of the benefit of its bargain given the facts presented here.

BPA is the entity, in the first instance, responsible for interpreting its enabling statutes and it would be difficult to conclude that the risk of legal error on BPA's part was somehow allocated to Port Townsend, which was essentially a *bona fide* purchaser for the value of power provided by BPA at a price determined by BPA.

Seeking recovery from Port Townsend through Clallam would be equally unlikely to succeed. Clallam was no more than an intermediary. Clallam did not use the provided power for its own purposes and it did not profit from the sale, recovering from Port Townsend only the rate paid to BPA plus other incidental and overhead costs attributable to providing service to Port Townsend. It would not be logical to conclude that Clallam was enriched, unjustly or otherwise. Finally, even if BPA were able somehow to extract a payment from Clallam, BPA believes that it would be nearly impossible for Clallam to recover from Port Townsend. Such a result, with Clallam shouldering any and all financial responsibility, would not be fair or just.

In conclusion, to the extent that a claim may exist, BPA believes the Government would have a low probability of litigating the matter to a successful conclusion. As a result BPA would be unable to provide a good faith justification for referring the matter to the United States Department of Justice for litigation. Even if BPA could justify such a recommendation, it is probable that DOJ's assessment of the legal complexities and the equities surrounding the facts would be the same as BPA's and the recommendation would ultimately be rejected.

III. BACKGROUND

A. 2007 Block Contracts

In *PNGC I*, petitioners challenged BPA's power sales agreements with Alcoa, CFAC, and Clallam PUD/Port Townsend. These contracts are collectively referred to in this ROD as the 2007 Block Contracts or Block Contracts.

Prior to the execution of the 2007 Block Contracts, BPA issued two records of decision regarding BPA's service to its DSI customers. The first, *Bonneville Power Administration's Service to Direct Service Industrial (DSI) Customers for Fiscal Years 2007-2011*, was issued June 30, 2005 (2005 ROD) (Attachment A), and the second, titled *Supplement to Bonneville Power Administration's Service to Direct Service Industrial (DSI) Customers for Fiscal Years 2007-2011*, was issued May 31, 2006 (2006 ROD) (Attachment B) (together the "DSI Service RODs").

In the 2005 ROD, BPA tentatively decided that it would offer a surplus power sales contract to each of its remaining three aluminum company DSI customers, totaling 560 aMW, at a capped cost of $59 million per year, and a 17 aMW surplus power sales contract to its one remaining non-aluminum company DSI customer, which would not be subject to the cost cap.[6] The 2005 ROD indicated that BPA would attempt to structure the delivery of service benefits through a contractual arrangement that included the public utility in whose service area the DSI is located, and that the default mechanism for providing benefits to the DSI aluminum companies would be financial payments, calculated by monetizing the value (relative to expected market prices) of each company's below-market surplus power sales contract, up to $12/MWh ($59 million cumulative annually) on each megawatt-hour allocated to each aluminum company. The final decision regarding whether benefits would be provided through these financial

[6] The three aluminum companies were Golden Northwest Aluminum (GNA), CFAC, and Alcoa. Of the 560 aMW, 100 aMW was allocated to GNA, 140 aMW to CFAC, and 320 aMW to Alcoa. GNA's 100 aMW allocation was subsequently reallocated to CFAC and Alcoa pursuant to the terms of the contracts. The non-aluminum DSI is Port Townsend.

payments or through physically delivered power, along with other implementation details, was left to the contract negotiations.

In November 2005, BPA made available for public review and comment a draft prototype DSI aluminum company contract. The prototype for the aluminum companies took the form of a three-party power sales contract under which BPA would make available for purchase by the local public utility partner for resale to the aluminum company the amount of surplus firm power allocated to each company by the 2005 ROD. For Port Townsend, BPA made available for public review and comment in December 2005 both a two-party (by and between BPA and the local utility partner only) and a three-party draft contract.

BPA evaluated comments received on these contracts, and several other unresolved service issues, in the 2006 ROD. Among other things, BPA decided in the 2006 ROD that: 1) it would neither increase nor decrease the $59 million cap on benefits available to the aluminum companies; 2) it would provide the aluminum companies some additional flexibility in the contracts to access the full measure of the available benefits under a wider-range of smelter operating conditions; and 3) the contracts with the smelters would allocate equally between BPA and the company the risk of a court issuing an order voiding or otherwise rendering the contract unenforceable as written, such that neither party would be liable to the other for any damages or refunds in that eventuality.

In June 2006 BPA signed the three-party Block Contracts (Attachments C and D) for service to Alcoa and CFAC, and in August 2006 BPA signed a two-party agreement (BPA/Clallam Contract) (Attachment E) with Public Utility District No. 1 of Clallam County, Washington, for service to Port Townsend. In turn, in September 2006, Clallam entered into a contract with Port Townsend for the resale of the surplus firm power purchased by Clallam from BPA under the BPA/Clallam Contract (Attachment F).

While the transactions between BPA and the aluminum companies share some similarities with the Port Townsend transaction, there are fundamental differences as well; including the fact that BPA did not have a direct contractual relationship with Port Townsend.[7] As a consequence, BPA has reviewed the aluminum company transactions separately from the Port Townsend transaction for purposes of this remand.

B. *PNGC I*

On December 17, 2008, the court issued its opinion in *PNGC I,* granting the petitions challenging the 2007 Block Contracts, and holding BPA had exceeded its statutory authority in selling the DSIs energy at rates below both the Industrial Firm (IP) power rate and the market rate. 580 F.3d at 827. BPA's preference utility customers argued that the DSIs received more benefits during the 26-month period (October 2006 through November 2008) preceding the court's opinion (Initial Lookback Period) than BPA was authorized by statute to provide them, and that the excess must be recovered by BPA

[7]However, Port Townsend is an intended third-party beneficiary to the BPA/Clallam Contract.

from the DSIs.[8] In response, Alcoa has argued that if BPA had applied the IP rate as it believes *PNGC I* required, then it would have received significantly more monetary benefits and, therefore, Alcoa is potentially entitled to recoup those additional payments.

In addressing the contention by certain preference utility petitioners that the damage waiver provision in the Block Contracts was void and that BPA must recover overpayments from the DSIs, *PNGC I* states:

> [T]he question of contractual interpretation before us is whether, if the agreements are partially invalidated, BPA is *permitted* to seek restitution, not whether it is 'requir[ed]'to do so. Whether BPA intended to retain the flexibility to seek *or* forgo repayment, depending on (a) the DSIs' 'commitments with respect to operating their facilities,' and (b) BPA's interest in still making sales of physical power to them, is an issue the agency did not address in the [2006] ROD.

Id. (emphasis in original). As noted by the court, BPA did not address this issue in the 2006 ROD, so the court remanded to BPA "to determine in the first instance the applicability and construction of the severability clause, the damage waiver, and the physical power sale option in light of our holdings here." *Id.*

As noted below, in January 2009, BPA, Alcoa, and Public Utility District No. 1 of Whatcom County, Washington, entered into Amendment No. 1 to the 2007 Block Contract, in an attempt to restructure and continue service to Alcoa in a manner consistent with the as-yet unamended *PNGC I* opinion.

In a June 10, 2009, letter to the region regarding the *PNGC I* remand (published prior to the issuance of *PNGC II*), BPA identified as key issues whether, as a matter of law and in view of the holdings in *PNGC I:*

1) BPA is permitted under the applicable contracts to seek repayment from the aluminum company DSIs Alcoa and Columbia Falls Aluminum Company for any overpayments of monetary benefits during the [Initial] Lookback Period;

2) Alcoa is permitted to seek additional payments from BPA for the [Initial] Lookback Period; and

3) BPA is permitted to seek additional payments directly from Port Townsend Paper Company (or indirectly through the Public Utility District No. 1 of Clallam County) for any undercharges for power delivered to Clallam by

[8]Certain aspects of the Port Townsend Lookback are addressed separately herein. The Port Townsend Lookback covers the 36-month period October 2006 through September 2009.

> BPA for the benefit of Port Townsend, both during the [Initial] Lookback Period and subsequently.[9]

In the letter, BPA established an approach and schedule for addressing the issues on remand, but noted that this could change in light of any subsequent orders or opinions by the court relevant to the Lookback determination, and that BPA would not issue any decision document until such time as the mandate had issued in *PNGC I*.[10]

The Ninth Circuit issued its revised *PNGC I* opinion, denying petitions for panel rehearing, on August 5, 2009.

C. Amendment No. 1 to the 2007 Block Contracts

BPA entered into an amendment to the 2007 Block Contracts with each of its DSI smelter customers following issuance of *PNGC I*, under which it continued to monetize surplus power sales to the companies, but based payment on the IP rate.

Only the Amendment to Alcoa's contract (Amendment) was challenged in *PNGC II*.[11] The Amendment covered the nine-month period January 1, 2009, through September 30, 2009, allowing continued service to Alcoa while BPA fully considered the ramifications of *PNGC I* for service to Alcoa during the final two years of the 2007 Block Contract (October 1, 2009 through September 30, 2011). Whatcom's obligations under the 2007 Block Contract were excused for the duration of the Amendment.

D. *PNGC II*

Petitions for review were filed challenging the Amendment with Alcoa, and on August 28, 2009, the court issued its opinion with respect to those petitions in *PNGC II*.[12] Among other things, the court held that "the amended Alcoa contract provision is invalid" because BPA failed to demonstrate that it reasonably believed its decision to enter into

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[9] As discussed below, the damage waiver and severability provision analysis is applicable only to the Block Contracts between BPA and the smelters.

[10] The June 10 letter is attached hereto as Attachment G. The letter proposed a two-step process, whereby BPA would first issue a draft record of decision addressing the specific legal issue remanded to BPA by the court regarding the severability and damage waiver provisions, and only in the event that it determined in a final record of decision that it could or must seek a refund from the companies (or that it could or must make additional payments to the companies), would it address issues regarding the amount of such refund or additional payments.

[11] Amendment No. 1 to Alcoa's power sales agreement is attached hereto as Attachment H.

[12] Approximately one month earlier, on July 24, 2009, BPA had issued a letter to the region delaying the publication of its draft record of decision on the Lookback. *See* Attachment I. BPA based the delay on the fact that the court had not yet disposed of certain petitions for rehearing in *PNGC I*, and also on the fact that the court, on an expedited basis, had heard oral arguments regarding the petitions for review challenging the Amendments, leading BPA to believe the court would soon issue an opinion in that case that could affect BPA's Lookback determinations.

the Amendment was consistent with "sound business principles." *PNGC II*, 596 F.3d at 1074.

Petitioners requested that the court order BPA to recover from Alcoa all "unlawful payments so that they can be refunded or credited to the customers of BPA who bore those costs in their rate." *Id.* at 1086. The court declined to do so, and instead remanded to BPA "to determine whether and how it will seek a refund from Alcoa." *Id.* The court noted that BPA had yet to address the "validity and applicability" of the damages waiver provision in the 2007 Block Contract, which the court mistakenly stated had been incorporated by reference into the Amendment. *Id.*[13] In addition, the court instructed BPA to "consider Alcoa's argument that no refund is due because the aluminum company, at the agency's demand, purchased wholesale power at rates well above what it could afford." *Id.* The court noted that it approached the case "with careful regard for the limited judicial role in overseeing BPA's execution of its obligations and authority." *Id.*

In response to *PNGC II*, BPA terminated payments to Alcoa being made pursuant to the Amendment, of which two remained to be made. Prior to issuance of *PNGC II*, BPA had made eight monthly payments (for the period December 2008 – July 2009) to Alcoa under the Amendment. This eight month period (Amendment Lookback Period) will be analyzed separately from the Initial Lookback Period.

E. Current Status

Following the court's issuance of its opinion in *PNGC II*, BPA worked toward completing the ongoing negotiations for new power sales contracts with its DSI customers consistent with the court's opinions.

BPA signed a power sales contract with Port Townsend (Contract No. 09PB-12106), and issued a record of decision regarding that contract, on November 13, 2009.[14] The BPA/Clallam and Clallam/Port Townsend contracts each have been terminated, although each specifies that "liabilities" (the BPA/Clallam Contract) or "obligations" (the Clallam/Port Townsend Contract) are preserved until satisfied. BPA is currently negotiating a power sales contract to provide continued service to Port Townsend following the expiration of the existing contract.

BPA signed a new power sales contract with Alcoa (Contract No. 10PB-12175), and issued a record of decision supporting that contract, on December 21, 2009.[15] The 2007

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[13]Section 2(j) of the Amendment states that section 16(c) of the 2007 Block Contract (the damage waiver provision) is deleted for the period of December 1, 2008 through September 30, 2009. *See* Attachment H.

[14] *See* Attachment J, *20.5 aMW Power Sale To Port Townsend Paper Company For The Period November 15, 2009 Through December 31, 2010 – Administrator's Record of Decision*. The term of this contract was subsequently extended by an additional five months. *See* Attachment K, *Five-Month Extension of 20.5 aMW Power Sale Contract No. 09PB-12106 With Port Townsend Paper Company – Administrator's Record of Decision*, issued December 24, 2009. The Industrial Customers of Northwest Utilities (ICNU) filed a petition for review on March 16, 2010, challenging this contract.

Block Contract with Alcoa was terminated pursuant to the December 2009 Contract. *See* Attachment L.

No agreement has been reached with CFAC. The 2007 Block Contract with CFAC is not being implemented in light of *PNGC I*, but has not been replaced, or formally terminated.

On March 2, 2010, the Ninth Circuit issued its revised *PNGC II* opinion. The revised opinion more directly addressed the possibility that a "decision to sell physical power to Alcoa might produce a different result." *PNGC II*, 596 F.3d at 1085.

IV. ALUMINUM COMPANY TRANSACTIONS

With respect to the aluminum company DSIs, BPA posited in its June 10 letter that the fundamental threshold issues on remand were 1) whether BPA is permitted under the applicable contracts to seek repayment from Alcoa and CFAC for any overpayments of monetary benefits during the Initial Lookback Period; and 2) whether Alcoa is permitted to pursue claims for additional payments from BPA for the Initial Lookback Period.[16] This is in keeping with the conclusions section of the *PNGC I* opinion, which stated in part:

> We GRANT the Cooperative's and Industrial Customers' petitions as to the challenges they bring regarding BPA's statutory authority to offer the aluminum DSIs and Port Townsend (through Clallam) energy at rates below both the IP rate and the market rate, and REMAND to the agency *for determination of the applicability of the agreements' severability and damage waiver provisions in light of our holdings*.

PNGC I, 580 F.3d at 827 (emphasis added).

As noted above, the damage waiver provision in the 2007 Block Contracts was not applicable during the Amendment period (December 1, 2008 through September 30, 2009), because it was expressly deleted in the Amendments with both Alcoa and CFAC for that period. *See* Attachment H, section 2(j). Therefore, this period will be addressed separately. *See* section IV.B.

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[15] *See* Attachment L, *Power Sale to Alcoa Inc. Commencing December 22, 2009 – Administrator's Record of Decision.* The term of the sale is firm for 17 months, with an additional five years of service possible if certain specified conditions are met. Certain parties, including Alcoa, have filed petitions for review challenging the contract. On October 29, 2010, BPA issued a ROD, in which it decided to extend the firm 17-month portion of the contract for an additional one year. *See* Attachment M, *Administrator's Record of Decision Granting Alcoa's Request to Extend the Initial Period of Alcoa's Power Sales Agreement, Contract No. 10PB-12175*.

[16] Unlike Alcoa, CFAC has not put forward a claim that it is owed additional benefits by BPA in light of *PNGC I*, but inasmuch as the CFAC and Alcoa contracts are identical in all respects relevant to the issues presented on remand, the following analysis applies to both Alcoa and CFAC.

A. BPA is contractually prohibited from seeking repayment from Alcoa and CFAC for any overpayments of monetary benefits during the Initial Lookback Period. Likewise, neither company is permitted to pursue claims against BPA under the Block Contract. (*PNGC I* remand item)

Issue 1.A.: **Is the invalid rate term severable and the damage waiver provision enforceable during the Initial Lookback Period?**

The discussion under Issue 1.A. and 1.B. applies to the 26-month period (October 2006 – November 2008) commencing with the first monthly payment made to each aluminum company under the 2007 Block Contracts, through the last payment made by BPA to each company for the month prior to the issuance of *PNGC I*. The final decision for both Issue 1.A. and 1.B. is found following Issue 1.B.[17]

Short Answer

The invalid rate term is severable and the damage waiver provision is enforceable by and against BPA during the Initial Lookback Period. The Block Contracts and *PNGC I*, as confirmed in *PNGC II*, contemplate severing the invalid rate, and the remaining enforceable terms of the Block Contract, including the damage waiver provision, remain valid and enforceable. The damage waiver is broad and unambiguous, and was not intended to apply only in the event a company ceased operations following a court decision invalidating the Block Contracts.

Discussion

The court indicated that the question on remand is whether BPA "is *permitted* to seek restitution, not whether it is 'requir[ed]' to do so." *PNGC I*, 580 F.3d at 827 (emphasis in original). This statement suggests that the court believes, at least in the first instance, that resolution of this threshold issue is largely a matter of contract interpretation, and that there is not necessarily an extra-contractual legal or equitable doctrine that would *require* BPA to seek repayment.[18] The damage waiver provision of the 2007 Block Contracts (section 16(c)) states:

> In the event the Ninth Circuit Court of Appeals or other court of competent jurisdiction issues a final order that declares or renders this Agreement void or otherwise unenforceable, no Party shall be entitled to

[17]The analysis and conclusions reached with respect to Issue 1.B., which evaluates preference customers' arguments that BPA is legally bound to seek restitution from each of the DSIs, are not dependent on the existence or non-existence of a damage waiver and also apply to the Port Townsend transaction.

[18] Whether BPA would be required as a matter of law to seek repayment from the aluminum companies (if it were not prohibited from doing so by application of the damage waiver provision) is discussed below in issue 1.B.

> any damages or restitution of any nature, in law or equity, from any other Party, and each Party hereby waives any right to seek such damages.

The severability provision of the Block Contract (section 14(i)) states:

> If any term of this Agreement is found to be invalid by a court of competent jurisdiction then such term shall remain in force to the maximum extent permitted by law. All other terms shall remain in force unless that term is determined not to be severable from all other provisions of this Agreement by such court.[19]

The next two sections (A. and B.) restate BPA's DROD analysis of the enforceability of the damage waiver provision. Following that, BPA summarizes parties' comments on the issue, and then evaluates those comments.

A. The invalid rate provisions are severable.

The court in *PNGC I* made several observations regarding the waiver and severability provisions that must guide BPA's response to the remand. In connection with the severability clause, the court observed that it was possible for BPA to serve the companies under the 2007 Block Contracts with physically delivered power in FY 2010 and FY 2011, leaving the option of severing the "monetized service benefit provisions of the agreement" and leaving "a possibly valid" physically delivered sale at an "as-yet unspecified rate."[20] *PNGC I*, 580 F.3d at 826.

To the extent the court was indicating that after severing the invalid rate provisions the contract could be enforceable as a physically delivered sale, then amending or replacing the Block Contracts to provide for a sale of physical power in FYs 2010-11 at a valid rate produces the same result contemplated by the court. In fact, as noted, in January 2009, BPA entered into an amendatory agreement with Alcoa for the remainder of FY 2009 that "suspend[ed] and replace[d]" the Block Contract for the period December 2008 through September 2009, in effect severing the invalid rate provisions, and replacing them with the IP rate. *See* Attachment H, *Amendment No. 1* (Contract No. 06PB-11744). In this

[19] BPA has read "that term" in the last sentence as referencing the invalid term. Therefore, the following analysis examines whether the invalid term is severable, rather than whether the valid terms are severable, as is often the analysis in cases discussing severability.

[20] Although BPA interprets the *PNGC* opinions as not invalidating the Block Contracts in their entirety, BPA notes that there is an alternative theory under which the power sale provisions of the Block Contracts could remain viable. The sales had been monetized because CFAC and Alcoa had each elected to exercise their options under section 5(c) of the Block Contract to lock-in the market price under their respective contracts, making their own five-year market purchases. In other words, the parties' election to forego physical sales was made based on the belief that the sales would be monetized. The price of their purchases was used as the surrogate market price for calculating monetary benefits under the Block Contract. However, because the monetization construct was not, in fact, a viable alternative, it is possible that, under the equitable theory of reformation, the contract could revert to a sale of physical power, and remain a valid contract.

circumstance every other term of the Block Contract, including the damages waiver provision, was intended to, and should as a matter of law, remain enforceable during the Initial Lookback Period.[21]

BPA believes that *PNGC I* and the Block Contracts themselves both contemplate severing the invalid rate in the event the parties to the contracts agree to proceed using a valid rate, and that the waiver provision remains valid and enforceable for the Initial Lookback Period. This result is consistent with the court's statement that it was not invalidating the Block Contracts in their entirety – implying that the invalid rate could be severed, and that the invalidity and unenforceability of the monetization provisions does not affect the remaining lawful obligations of the parties, including the damages waiver provision. Even though BPA no longer had the option under the Block Contract to *require* that the smelters accept physically delivered power, nothing in *PNGC I* precluded the parties from amending or replacing the contracts to provide for continued service. More importantly, by observing that the Block Contract could remain viable in FY 2010-11, the court implicitly acknowledged that the invalid monetized rate must be severable, *i.e.*, that it could be severed and replaced with an "as-yet unspecified rate." *PNGC I*, 580 F.3d at 826.

This conclusion is not changed by *PNGC II*, in which parties challenged payments made by BPA to Alcoa during the Amendment period. The court in *PNGC I* specifically stated that "[w]e do not hold that the contracts are void 'as if no[ne] ever . . . existed." *PNGC I*, 580 F.3d at 827 (ellipses in original). The court in *PNGC II* did not indicate it was changing that specific holding or otherwise amending its opinion in *PNGC I*. In other words, the court's holding in *PNGC II* that BPA must demonstrate that a discretionary power sale to a DSI is consistent with sound business principles must be presumed to be consistent with *PNGC I*, and therefore the court's express holding in *PNGC I* that it was only invalidating the monetized rate provisions of the Block Contract remains valid and is the law of the case for purposes of this remand.

B. The waiver provision is comprehensive.

Even if the invalid rate term may be severed, leaving the remainder of the Block Contract intact (including the waiver provision), the court noted that BPA's rationale in the 2006 ROD for declining to require the DSIs to refund money in the case of contract invalidity did not apply since the "actual contract language and factual circumstances here are significantly different from the proposal BPA rejected in the [2006] ROD."[22] 530 F.3d at 827. The court stated that its invalidation of the monetization formula "did not

[21] *See, e.g.*, Cal. Pac. Bank v. Small Bus. Admin., 557 F.2d 218, 223 (9th Cir. 1977) (illegal contracts are unenforceable only where statute explicitly provides that contracts contravening it are void or where interest in contract's enforcement is outweighed in circumstances by public policy against enforcement of such terms); *Cf.* Kelly v. Kosuga, 358 U.S. 516, 519 (1959) (enforcing contract does not violate the Sherman Act, and noting that courts should not be quick to create a policy of non-enforcement of contract beyond provisions which are clearly violative of statute).

[22] The "proposal" referred to was the proposal by public utility customers that the Block Contracts include a provision requiring repayment by the aluminum companies in the event of contract invalidity.

necessarily foreclose the DSIs' 'prospects of operating their smelters'" and that "[w]e do not hold that the contracts are void 'as if no[ne] . . . ever existed.' Instead we *affirm* the authority of BPA to sell physical power to the DSIs, § 839c(d), at a valid rate." *Id.* (emphasis in original, quoting 2006 ROD).

With respect to the damages waiver provision, the court stated that what it needed to know was whether BPA "intended to retain the flexibility to seek *or* forgo repayment, depending on (a) the DSIs' 'commitments with respect to operating their facilities,' and (b) BPA's interest in still making sales of physical power to them . . . ." *Id.* (emphasis in original). Taking first the question of the DSIs' "commitments with respect to operating their facilities," this phrase was quoted by the court from the 2006 ROD, which was referring to the companies' business commitments, such as labor, raw materials, market power purchases, and other smelter production input commitments that would have been made in anticipation of receiving from BPA a known level of monetary benefits. The point being made in the 2006 ROD was that it would be inequitable if the companies were on the hook for such commitments, and the court invalidated the Block Contracts, to then require repayment by the companies to BPA of some or all benefits paid to date. However, it was not BPA's intent that the waiver would apply only in the event the Block Contracts were invalidated *and* not replaced or amended. Presumably, this is the issue implicit in the court's second question regarding "BPA's interest in still making sales of physical power to [the companies]" and whether BPA intended to retain flexibility to "seek *or* forgo repayment" for earlier overpayments in the case where it was interested in continuing to make sales to the companies.

BPA believes the intent of the parties on this issue is best expressed by the plain language of the waiver provision itself, and that neither BPA nor the aluminum company retained any right - or as the court put it "flexibility" - to seek damages or repayment under any set of circumstances associated with the court invalidating the Block Contract in whole ("void") or in part ("otherwise unenforceable"). BPA believes this includes the circumstance where a contract, as here, was 1) partially invalidated due to the use of an invalid rate; and 2) amended for FY 2009 to substitute what BPA believed was a valid rate, with the result that the companies continued operating, with the possibility of additional power sales by BPA to the companies for the FY 2010-2011 period.[23] In this entirely commercial context, and particularly given the difficulties inherent in the competitive global aluminum market, commercial certainty and predictability were served by the provision.

BPA's discussion of the damage waiver provision in the 2006 ROD, in response to comments with respect to that provision, was not intended by BPA to limit, and BPA believes as a legal matter does not limit, application of the waiver provision only to the circumstances addressed in the 2006 ROD. The waiver language is broad and unambiguous, and clearly contemplates its application in other circumstances, including

[23] It seems implicit in this that BPA did not intend to retain flexibility "to forgo" seeking repayment (which implies a right to seek repayment in the first instance) since the better argument is that each party is precluded from seeking repayment *at all* by the terms of the contract.

such as here where the contract is "otherwise unenforceable" due to the invalid rate term, but is not entirely void, and where the invalid rate term is severed and replaced.

Beyond that, to the extent that the court indicated that BPA's intent with respect to retaining an ongoing commercial relationship with its DSI customers was relevant, BPA has already entered into replacement contractual arrangements with Alcoa and Port Townsend (and continues to work with CFAC to develop such an arrangement). Thus, it is clear that BPA's intent is, and would have been, to continue to make physical sales of power to the DSIs.

C. Comments on BPA's damage waiver analysis

PPC argues that the damage waiver provision is unenforceable: "[A]llowing an agent of the government (the Administrator) to pay out money in contravention of an appropriation runs wholly against the Constitution's vesting of the spending power in the legislative branch . . . ." PPC at 7. Moreover, PPC believes that the clause is inseparable from the illegal purpose of the contract, noting that the waiver provision, if enforced, "would have the effect of implementing the very deal the Court found unlawful." *Id.* (citing Restatement (Second) of Contracts § 183, Cmt. A. (1981) (severing one part of an agreement from another part is allowable only when the severed provision "does not materially advance the improper purpose")).

PNGC generally argues that BPA's obligation to operate consistent with sound business principles compels it to seek recovery from the DSIs. PNGC at 1. NRU also believes the damage waiver provision is unenforceable, and that as a consequence of *PNGC I* that BPA "has an affirmative duty, as a federal agency, to recover amounts paid to the DSIs in excess of the benefits the DSIs were entitled to receive." NRU at 1. NRU states that the damage waiver is unenforceable because "BPA had no authority to offer the DSIs a rate below the IP rate." NRU at 1 (citing Fansteel Metallurgical Corp. v. United States, 172 F. Supp. 268, 270 (Ct. Cl. 1959)). NRU claims that BPA is required by article IV, section 3, clause 2 of the Constitution to recover money paid "erroneously or illegally . . . from the public treasury." *Id.* NRU also disagrees with BPA's conclusion in the DROD that payments made from the BPA Fund do not implicate the same constitutional considerations raised in *Fansteel*. In this connection NRU cites the Federal Columbia River Transmission System Act of 1974:

> The [BPA] Administrator may make expenditures from the fund, which shall have been included in his annual budget submitted to Congress, without further appropriation . . . *for any purpose necessary or appropriate to carry out the duties imposed upon the Administrator pursuant to law*.

NRU at 2 (citing 16 U.S.C. § 838i(b) (emphasis added by NRU)). NRU notes the Transmission System Act goes on to list those duties to include "making such payments, as shall be required to carry out the purposes and provisions of the [Northwest Power Act] . . . ." 16 U.S.C. § 838i(b)(12). NRU concludes from this that because "the court held in *PNGC I* and *II* that the benefits paid to the DSIs are not included in the proper purposes under the Northwest Power Act" that BPA must recover the payments to the DSIs. NRU at 2. Lastly, NRU cites to the so-called "*Wurts* line of cases" for the proposition that "only Congress has the ability to bar recovery of monies unlawfully paid." NRU at 2 (citing United States v. Wurts, 303 U.S. 414 (1938); Maryland Small Business Development Financing Authority v. United States, 4 Cl. Ct. 76 (1983)). Therefore, NRU concludes, BPA's damage waiver provision cannot bar recovery. ICNU likewise argues BPA is prohibited from waiving the right to seek repayment of illegal payments, and that in any case the 2006 ROD makes clear that the waiver was intended to apply only if the Block Contract was invalidated and the DSI ceased operations. ICNU at 2.

The IOUs, by contrast, agree with BPA's initial determination in the DROD that the damage waiver provision is severable and enforceable, thus precluding BPA from seeking Lookback payments from the DSIs. IOUs at 1-7. The IOUs cite extensively to the 2007 Block Contract ROD at 17, the 2009 Alcoa ROD at 29, and DSI Lookback DROD at 9, for BPA's rationale for the contractual waiver provisions included in the 2007 Block Contracts and the recently signed contract with Alcoa.[24] In conclusion, the IOUs note "BPA thus recognized (correctly) that the 'damages waiver' provision was added because BPA viewed the provision as providing an equitable allocation of the risk of invalidity between BPA and the DSIs. BPA cannot and should not retroactively abandon its reasons for entering into the 'damages waiver'." IOUs at 4.

The IOUs also point to the court's unwillingness to grant preference customers' demands that BPA pay refunds, noting that the court found the relevant inquiry was whether "BPA is permitted to seek restitution, not whether it is 'requir[ed] to do so" and stated explicitly that "there is a significant possibility that the DSIs do not owe BPA a refund." IOUs at 4 (citing *PNGC I*, 580 F.3d at 882; *PNGC II*, 596 F.3d at 1081 n.11). The IOUs note further that "[l]imitations on remedies . . . are lawful contractual tools to allocate risks relating to contract invalidity. . . [a]nd BPA . . . is bound to honor its contracts." IOUs at 5 (citing Franconia Assocs. v. United States, 526 U.S. 129, 141 (2002) ("The United States does business on business terms.")).

The IOUs also point out that the damage waiver provision essentially adopts the common law rule for the treatment of parties to a contract that is declared unlawful or unenforceable in whole or in part (*i.e.*, "[t]he usual remedy for an illegal or unenforceable contract is to refuse to enforce the contract or otherwise leave the parties as the court finds them at the time the illegality is discovered, not to restore them to the same position they would have been in had the contract never existed," IOUs at 5 (citing 17A, Am. Jur. 2d, contracts § 322 at 308 (2004)), and that contract relations with the United States are generally governed by the laws applicable to private individuals. IOUs at 5 (citing United States v. Winstar Corp., 518 U.S. 839, 895 (1996)).

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[24] The IOUs reference to the "2007 Block Contract ROD" is to the *Supplement to Bonneville Power Administration's Service to Direct Service Industrial (DSI) Customers for Fiscal Years 2007-2011*, which is referred to herein as the "2006 ROD."

Finally, the IOUs note that "[n]o public policy or other grounds justify ignoring or invalidating the 'damages waiver' provision." IOUs at 5. The IOUs cite numerous cases in support of the proposition that, unless specifically precluded from doing so, the Government may enter into contracts that shift financial responsibility to itself in the event of the occurrence of certain events, and may waive its right to recover mistakenly or erroneously paid sums. IOUs at 5 (citing *Winstar*, 518 U.S. 839, 907; Applied Cos. v. United States, 144 F.3d 1470, 1476 (Fed. Cir. 1998); Fansteel Metallurgical Corp. v. United States, 172 F. Supp. 268, 270 (Ct. Cl. 1959) (where court seemingly acknowledged duty to recover funds could be waived in the event contract provided for such a result)).

The IOUs also conclude that BPA correctly determined that the damage waiver provision is a severable term of the 2007 Block Contract, and that such a determination is dependent on the intent of the parties. IOUs at 6 (citing Booker v. Robert Half Int'l, Inc., 413 F.3d 77, 84 (D.C. Cir. 2005) ("A critical consideration in assessing severability is giving effect to the intent of the contract parties.")). The IOUs state that the intent of the parties is clear with respect to the severability issue:

> Here, the 2007 Block Contract expressly included a severability clause that applied to the "damages waiver." (Section 14(i) of the 2007 Block Contract.) The 2007 Block Contract ROD also made clear that the "damages waiver" was intended to be severable and to apply even if the underlying contract were found unlawful or unenforceable in its entirety . . . . BPA also correctly concludes that the parties intended the "damages waiver" to apply even if the 2007 Block Contracts were only partially invalidated. (See Draft ROD at 9-10.) The intent of the parties should control, and the "damages waiver" is enforceable regardless of whether any other part of the 2007 Block contract survived appellate review.
>
> In its 2007 Block Contract ROD and its 2009 Alcoa ROD, BPA correctly recognized that the enforceability of the "damages waiver" does not depend on the survival of any other part of the underlying contracts. . . [I]n the 2007 Block Contract ROD, BPA expressly contemplated the "damages wavier" as applying in the event that "the contracts are held void. . . . In its 2009 Alcoa ROD, BPA similarly stated that "damages waiver" provisions "are lawful and represent a reasonable allocation of risks between the parties associated with an invalidation of the Block Contract, *in whole or in part*." BPA's reasoning in those RODs was correct and BPA should adhere to that reasoning.

IOUs at 6 (emphasis added by IOUs, citing 2009 Alcoa ROD at 30).

In cross-comments, PPC disagrees with the IOUs' statement that the Ninth Circuit does not view the damages waiver provision as "inherently unenforceable." PPCcx at 3 (citing IOUs at 1). According to PPC, this issue was not decided in *PNGC I* or *II* because the court remanded this question to BPA. The issue was only remanded again in *PNGC II* because "BPA had yet to take action on the question from the first remand before signing a new contract with Alcoa after the Court's decision in *PNGC I*." PPCcx at 3.

In its comments, Alcoa argues that "[i]n *PNGC II*, the Court ruled that BPA had not erred because 'there is a significant possibility that the DSIs do not owe BPA a refund.'" Alcoa at 2 (quoting *PNGC II*, 596 F.3d at 1081 n.11). Alcoa points out several times that the damages waiver provision is reciprocal, and if BPA were to conclude that the damage waiver is unenforceable, Alcoa would be able to bring damages claims against BPA. Alcoa at 2, 4, 9. According to Alcoa, its claims against BPA are in excess of any claims BPA might have against Alcoa. *Id.*

Alcoa agrees with BPA's draft conclusion that the invalidated payment provisions are severable and that the damage waiver provision is enforceable, citing the court's statement that "[w]e do not hold that the contracts are void 'as if no[ne] . . . ever existed." *PNGC I*, 580 F.3d at 826. A plain reading of the contract, Alcoa submits, supports its conclusion that the terms are severable. The contract explicitly states that if any term of the contract is invalidated, "[a]ll other terms shall remain in force unless that term is determined not to be severable from all other provisions . . . ." Alcoa at 4. Because the court did not hold that the other terms of the contract were not severable, Alcoa concludes the damage waiver remains enforceable. *Id.*

In its cross-comments, PPC expresses its disagreement with contentions raised by Alcoa. In response to Alcoa's assertion that the damages waiver provision is applicable (or inapplicable) to both BPA and Alcoa equally, PPC states "this theory that Alcoa and BPA are on equal terms when it comes to the waiver clause is unsupportable in light of established case law." PPCcx at 1. PPC refers to several cases cited in its initial comments to support this conclusion. Essentially, the PPC argues that BPA, as a government agency, has a duty which is imposed by statute, case law, and the Constitution to recover the funds, but Alcoa, as a private business, willingly waived its claims against BPA. *Id.*

Additionally, PPC contends that Alcoa does not have a claim for damages against BPA, because Alcoa is not entitled to purchase power from BPA at a specific rate. *Id.* at 2. Therefore, PPC argues, Alcoa could not have sustained damages for receiving benefits from BPA. PPC believes that, while Alcoa has no right to enforce any legal or equitable claims against BPA, BPA has the right and duty to initiate collection actions and refer the matter to litigation, if necessary, to enforce BPA's purported rights. PPC disagrees with Alcoa's statement that "[n]o legal or equitable basis exists – under contract, restitution, or any other 'mechanism or process' – for BPA to receive a refund of any Monetary Benefit payment made to Alcoa under the Block Contract or Amendment." PPCcx at 2 (citing Alcoa at 6). As discussed in PPC's initial comments, PPC argues that it is "well-established" that the Government can recover funds which have been wrongfully, erroneously, or illegally paid, unless Congress has prohibited recovery by statute. PPCcx at 2 (citing United States v. Wurts, 303 U.S. 414, 415 (1938); Old Republic Ins. Co. v.

Fed. Crop Ins. Corp., 746 F. Supp. 767, 770 (N.D. Ill. 1990)). Cross comments of ICNU, PNGC, and NRU are essentially in agreement.

Alcoa responds to PPC's theory in its cross-comments. Generally, Alcoa reiterates that: 1) the damage waiver is enforceable; and 2) if it is not enforceable against BPA, it is not enforceable against Alcoa. Alcoa rejects the argument that BPA has an affirmative duty to seek recovery and asserts that the analyses of PNGC, PPC, ICNU, and NRU are "myopically focused on the court's narrow invalidation of the Monetary Benefit construct and ignore the court's other central holdings." Alcoacx at 3. These other central holdings are, according to Alcoa: a) BPA is authorized to sell physical power to DSIs; b) if BPA does sell physical power to DSIs, it must be at the IP rate; c) the Block Contracts are not void *ab initio*; and d) the court expressly refused to issue an order that BPA must seek to recover Monetary Benefit payments from Alcoa and instead remanded the issues of the application and enforceability of the severability and damage waiver clauses, and whether BPA or Alcoa is entitled to a refund. *Id.*

The IOUs also take up the issue in their cross-comments. IOUscx at 2. The IOUs assert that PPC's argument that the provision is unenforceable because it "would have the effect of implementing the very deal the Court found unlawful" is incorrect because the damages waiver is a limitation on remedies, not an agreement to implement the 2007 Block Contracts even if the court found them invalid. IOUscx at 2 (quoting PPCcx at 7). According to the IOUs, limitations on remedies are not unlawful and are a common way to allocate risk in contracts. The IOUs also note that BPA was not attempting to use the damages waiver to provide excess benefits to the DSIs, but rather included the damages waiver for the purpose of protecting both BPA and the DSIs from claims in the event that the contract was found invalid. The IOUs also assert that the Ninth Circuit did not order any particular remedies, and cite the description of the relevant inquiry on remand: "whether BPA is *permitted* to seek restitution, not whether it is require[ed] to do so." IOUscx at 2 (citing *PNGC I*, 580 F.3d at 827 (emphasis in original)).

D. Evaluation of comments

As described above, BPA believes the damage waiver provision is severable and enforceable as a matter of contract interpretation. This conclusion is based, in part, on the language of the remand order itself, which strongly indicates that the court believes that the tools of contract interpretation, including determining the intent of the parties, are the primary indicators with respect to deciding whether BPA "is *permitted* to seek restitution, not whether it is 'requir[ed] to do so." *PNGC I*, 580 F.3d at 827 (emphasis in original). BPA believes the damage waiver is severable in that the Block Contracts "contemplate severing the invalid rate in the event the parties to the contract agree to proceed using a valid rate, and that the remainder of the Block Contract, including the waiver provision, remains valid and enforceable." DROD at 8. BPA has entered into amendatory and/or new contracts with both Alcoa and CFAC, which in itself evinces its intent to continue to make physically delivered power available to DSIs at a valid rate, consistent with all other legal standards. The court indicated this may be an important factor in determining the severability question.

In addition, it was the intent of the parties that the waiver would be applied in all cases involving a successful challenge of the Block Contracts, not just those where a company ceased operations as a consequence of the contract being invalidated in whole or in part. This intent is reflected in the language of the waiver itself.

The damage waiver provision represents a fair trade-off in an arm's length transaction where the parties were, to some degree, at odds regarding the legal standard that would ultimately apply to DSI sales now that they are discretionary. In such a situation, the damage waiver provision is an appropriate means of limiting potential future financial risk to both parties, risks that obviously have to be addressed in commercial transactions of the sort being addressed here.

As noted above, the IOUs have posited that *United States v. Winstar Corp.*, 518 U.S. 839 (1996), and other cases support the legality of the damage waiver provision. BPA agrees that *Winstar* supports the conclusion that BPA may by contract accept the risk (and the attendant financial liability) associated with changes in the law (or, as in this case, later court interpretations of the law existing at the time of contract formation) that render continued performance by the Government, of some or all of the terms in the contract, inconsistent with such law.

In *Winstar*, an agency of the United States had entered into contracts with several parties, including Winstar Corporation, in which it agreed, as inducement for those parties to acquire failing thrift institutions, that particular accounting treatments could be used to calculate the regulatory capital requirements applicable to these thrift institutions, and that such accounting treatments would apply notwithstanding any change in the law prohibiting their use. Congress subsequently changed the law prohibiting the use of the subject accounting treatments. As a result, Winstar failed to meet the required capital requirements, and as a consequence federal regulators seized and liquidated the Winstar thrift.

The Court held that although Congress subsequently changed the relevant law, thereby barring the Government from specifically honoring its promise regarding the accounting treatment to be used, the terms of the contracts assigning the risk of regulatory change to the Government were enforceable, and the Government was liable in damages for breach. 518 U.S. at 843. Fundamentally, the Court's main holding acknowledged that the Government could assume through contract the obligation to pay damages to a counterparty resulting from a change in the law that otherwise prohibited the Government from performing its obligations to that counterparty under the contract.

The United States asserted four defenses to Winstar's claims for breach which are unique to the Government:

1. the canon of contract construction that surrenders of sovereign authority must appear in unmistakable terms;

2. the rule that an agent's authority to make such surrenders must be delegated in express terms;

3. the doctrine that a government may not, in any event, contract to surrender certain reserved powers; and, finally,

4. the principle that a government's sovereign acts do not give rise to a claim for breach of contract.

518 U.S. at 860. The Court dismissed each of these affirmative defenses on basically the same grounds: that a contract to adjust the risk of subsequent legislative change does not strip the Government of its legislative sovereignty, and the contracts did not surrender the Government's sovereign power to regulate. *Id*. at 880-81. In other words, the new law was effective against Winstar, and the contractual promise made by the Government regarding the accounting treatment was no longer enforceable, but there was no legal prohibition against the United States paying damages to Winstar as a consequence of what the Court characterized as a breach of its promise.

While *Winstar* involved the allocation of risk between the Government and a private party with respect to any subsequent change in the law that would basically render the contract unenforceable as written, this case involves the subsequent (post-contract formation) interpretation of the law as it existed at the time of contract formation, which likewise rendered the contract unenforceable as written. But the cases are similar because in each case the Government had contractually agreed how a *subsequently arising event* that adversely impacted its ability to perform its obligations would be treated by the parties. In *Winstar*, the Government took the risk; in this case, the risk was essentially allocated evenly between the parties. The Court recognized that Government contracts "routinely include provisions shifting financial responsibility to the Government for events which might occur in the future. That some of these events may be triggered by sovereign Government action does not render the relevant contractual provisions any less binding than those which contemplate third party acts, inclement weather and other *force majeure*." *Winstar*, 518 U.S. 839, 908 (citing Hughes Commc'ns Galaxy, Inc. v. United States, 998 F.2d 953, 958-59 (C.A. Fed. 1993)).

Along the same lines, the Court in *Winstar* cited numerous cases that support the concept of "sanctity of contract" in cases involving individuals contracting with the Government.[25]

[25] *See, e.g.*, Detroit v. Detroit Citizens' Street Ry. Co., 184 U.S. 368, 384 (1902) (rejecting as "hardly . . . credible" the city's suggestion that the fare rate agreed on with railroad company, which "amounted to a contract," would be "subject to change from time to time" at the city's pleasure); Murray v. Charleston, 96 U.S. 432, 445 (1878) (a government contract "should be regarded as an assurance that [a sovereign right to withhold payment] will not be exercised. A promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity"); New Jersey v. Yard, 95 U.S. 104 (1877) (same); Lynch v. United States, 292 U.S. 571 (1934) (invoking the general principle that the government is ordinarily treated like a private party when it enters into contracts); Perry v. United States, 294 U.S. 330 (1935) (same); Sinking Fund Cases, 99 U.S. 700 (1879) ("The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach

It may be argued, to some extent, that *Winstar* is not a perfect fit in this situation. Notwithstanding the fact that the *PNGC* court did not invalidate the DSI contracts, it did hold that BPA violated its statutes in that it 1) used the wrong rate to calculate benefits paid to the DSIs, and 2) the contracts themselves were entered into under a rationale the court determined did not meet with sound business principles. In *Winstar,* on the other hand, the Court noted that there was no question that the agency had "ample statutory authority" under the law at the time the contract was entered into to make the contractual commitment to Winstar regarding the use of the special accounting treatment. 518 U.S. at 890.

Nonetheless, as discussed in Issue 1.B. below, this is not a situation where the Administrator was acting totally outside the scope of his authority, which would provide a better case for nullifying the contract in its entirety. Instead, while BPA was mistaken in its application of the law, it did not exceed its statutory authority in entering into power sales contracts with the DSIs, and the waiver promise it made and received therein, to the extent severable from the invalid rate provisions, is enforceable by and against it. As discussed more fully below, such a result is consistent with how courts typically deal with contracts that are tainted to some degree by a procedural irregularity or error in the implementation of lawful authority. Such contracts are not void *ab initio* or considered to be *ultra vires* acts which would render the contract a nullity. Instead, the contract is typically reformed, to the extent possible, or the rights of the non-government contractor are preserved in some other way.

As noted above, the final decision for both Issues I.A and I.B appears at the end of Issue 1.B.

Issue 1. B.: **Whether BPA's expenditures for service to the DSIs violated the Appropriations Clause of the United States Constitution, or any statute or regulatory requirement, such that BPA must, as a matter of law, initiate collection actions against the smelter DSIs for monies paid to them under their contracts, or in the case of Port Townsend, to extract additional payments for power sold to Clallam for Port Townsend's benefit?**

Short Answer

BPA is not required as a matter of law to initiate collection against the smelter DSIs or Port Townsend because there has been no violation of the Appropriations Clause, and no statute or regulation cited by preference customers, or otherwise known to BPA, imposes such a duty on BPA in this case. Expenditures in support of service to the DSIs are authorized by Congress, and legal errors in the implementation of that authority, in and of themselves, do not provide sufficient grounds for asserting a violation of the

that term implies, as it would be if the repudiator had been a State or a municipality or a citizen."); United States v. Klein, 13 Wall. 128, 144, 20 L.Ed. 519 (1872) (same).

Appropriations Clause and nullifying contracts that are authorized under enabling legislation.

Discussion

PPC and other preference customers have asserted that BPA has a legal duty to undertake collection efforts with respect to monies paid to Alcoa and CFAC pursuant to the 2007 Block Contracts, and to seek restitution from Port Townsend for alleged underpayments by Port Townsend for BPA supplied power under the BPA-Clallam-Port Townsend transaction. PPC states that:

> [T]he obvious course of action for BPA is to pursue a recovery of the funds it has paid out unlawfully. Good policy and adherence to the law requires BPA to do so; an apathetic or intentional approach of leaving the funds with the DSIs runs headlong into fundamental requirements placed on the executive branch.

PPC at 2. *See also* ICNU at 2; NRU at 2, 5.[26] These customers argue this duty to seek recovery arises inasmuch as expenditures by BPA in connection with the 2007 Block Contracts violate the Appropriations Clause of the United States Constitution.[27]

The preference customers are incorrect. In this case, even if BPA had determined that a claim exists, there would be no Appropriations Clause violation because expenditures in support of service to DSI customers are authorized by Congress, and the appropriation for such expenditures was made by Congress on a permanent and indefinite basis through creation of the Bonneville Fund. Factual or legal errors made by BPA in the implementation of its statutory authority, in and of themselves, do not provide sufficient grounds for asserting a violation of the Appropriations Clause and nullifying contracts that are otherwise authorized under law, as suggested by preference customers. BPA's conclusions in this ROD should not be misread as meaning, if BPA found that a viable claim existed, that the agency would not pursue it by appropriate action. BPA is only concluding that preference customers are incorrect in asserting that the Administrator would have a mandatory constitutional duty, pursuant to the Appropriations Clause, to take affirmative steps to pursue such claims in this case.

A. Congress has vested the Administrator with a high degree of flexibility in making expenditures from the Bonneville Fund and such expenditures are authorized for purposes of appropriations law.

[26] Many of the arguments made by PPC are also made in comments of other preference customer groups. For convenience, in some cases where the same argument is made by more than one preference group, only PPC's comments are cited.

[27] The Appropriations Clause provides: "No money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." U.S. Const., art. I, § 9, cl. 7.

When Congress enacted the Federal Columbia River Transmission System Act in 1974, one of its purposes was to remove BPA from the traditional appropriations process and place the agency's operations on a self-financed basis. It did so by creating a separate fund in the Treasury, available for use by the Administrator without further appropriation and without fiscal year limitation. 16 U.S.C. §§ 838, 838i(a), (b) (2006). The composition of the Bonneville Power Administration Fund ("Fund") includes the following items:

> (1) all receipts, collections, and recoveries of the Administrator in cash from all sources, including trust funds, (2) all proceeds derived from the sale of bonds by the Administrator, (3) any appropriations made by the Congress for the fund, and (4) the following funds which are hereby transferred to the Administrator: (i) all moneys in the special account in the Treasury established pursuant to Executive Order Numbered 8526 dated August 26, 1940, (ii) the unexpended balances in the continuing fund established by the provisions of section 832j of this title, and (iii) the unexpended balances of funds appropriated or otherwise made available for the Bonneville Power Administration.

Id. Congress made the Fund "available for expenditure by the Secretary of Energy, acting by and through the Administrator, as authorized in this chapter and any other Act relating to the Federal Columbia River transmission system, subject to such limitations as may be prescribed by any applicable appropriation act effective during such period as may elapse between their transfer and the approval by the Congress of the first subsequent annual budget program of the Administrator." *Id.*

Use of the Fund is overseen in three ways. First, expenditures from the Fund are to be included in the "annual budget submitted to Congress" but such expenditures may be made "without further appropriation and without fiscal year limitation." 16 U.S.C. § 838i(b). Second, the Act also makes BPA subject to provisions of the Government Corporation Control Act as it pertains to wholly owned Government corporations (31 U.S.C. § 9101) "but nothing in section 9105(d) of title 31, shall be construed as affecting the powers granted in subsection (b)(11) of this section and in sections 832a(f), 832i(b), and 832i(a) of this title." 16 U.S.C. § 838i(c). Third, the Act provides that "the financial transactions of the Administrator shall be audited by the Comptroller General at such times and to such extent as the Comptroller General deems necessary, and reports of the results of each such audit shall be made to the Congress within 6-1/2 months following the end of the fiscal year covered by the audit." 16 U.S.C § 838i(d). Expenditures may only be made "within such specific directives or limitations as may be included in appropriation acts." *Id.*

Apart from "specific directives or limitations as may be included in appropriations acts," the Administrator is authorized to make expenditures from the Fund "for any purpose necessary or appropriate to carry out the duties imposed upon the Administrator pursuant to law." 16 U.S.C. § 838i(b). The Act then provides a non-exclusive list of items for which expenditures from the Fund are specifically authorized, including "marketing of electric power." 16 U.S.C. § 838i(b)(4).

Thus, it is clear that, subject to the oversight provided above, and specific limitations imposed by appropriations acts, Congress has granted the Administrator a high degree of latitude with respect to using the Fund for a wide range of purposes established in BPA's enabling legislation.[28] The Appropriations Clause assures that public funds will be "spent according to the difficult judgments reached by Congress." Office of Pers. Mgmt. v. Richmond, 496 U.S. 414, 428 (1990). By creating the BPA Fund Congress delegated to the BPA Administrator responsibility for making the "difficult judgments" associated with marketing electric power, including discretionary power sales to DSI customers.

However, to suggest, as preference customers have done, that any expenditure made in connection with marketing power to the DSIs that is based on a mistake of fact or law constitutes a violation of the Appropriations Clause, reflects a misunderstanding of appropriations law. BPA understood at the time the Block Contracts were developed there were legal risks with respect to implementation of the Administrator's substantive authority to serve the DSIs. Ever since sales to DSIs became discretionary, there has been, and continues to be, litigation regarding what Congress intended by making such sales discretionary, rather than mandatory. Neither BPA's enabling statutes, nor the legislative history thereto, provide definitive guidance. The court in *PNGC I* and *II* has identified legal guideposts that must now inform BPA's implementation of that authority. That, however, does not impinge upon the Administrator's broad authority to make expenditures from the Bonneville Fund for the purpose of "marketing electric power."

As explained below, BPA is not arguing that there can never be an expenditure from the BPA Fund that would violate the Appropriations Clause, but rather only that in the event that an expenditure is made with respect to a field, subject matter, or object for which the Administrator has authority to incur obligations, then the fact that some aspect of the exercise of that authority was undertaken pursuant to a mistake of fact or law does not implicate the Appropriations Clause.[29]

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[28] Even prior to creation of the Fund, the Government Accountability Office (originally General Accounting Office) (GAO) recognized the wide discretion to make expenditures that Congress vested in the Administrator: "[T]he legislative history of BPA's enabling statute indicated that Congress intended that it have a degree of freedom similar to public corporations and that it be largely free from 'the requirements and restrictions ordinarily applicable to the conduct of Government business'." *See generally* GAO, Principles of Appropriations Law (Third Ed.), Vol. 1 (Jan. 2004) at 4-25.

[29] In *Office of Personnel Management v. Richmond*, 496 U.S. 414, 435 (1990), Justice Stevens (concurring), while agreeing in the holding that estoppel against the government was not available in the case, argued the Appropriations Clause analysis used by the majority to reach that conclusion was wrong, and that the Appropriations Clause was not implicated, even in a case where promissory estoppel was sought to compel the government to make future pension payments erroneously promised under a mistake of law:

> Payments of pension benefits to retired and disabled federal servants are made "in Consequence of Appropriations made by Law" even if in particular cases they are the product of a mistaken interpretation of a statute or regulation. The Constitution contemplates appropriations that cover

In conclusion, while the court in the *PNGC* cases held that BPA made legal errors in the manner in which it implemented its authority to serve DSI load, case law does not support the conclusion by preference customers that, as a consequence of this legal error, that expenditures in support of such contracts violate the Appropriations Clause of the United States Constitution.[30]

B. Cases relied upon by PPC and others do not support the conclusion that the 2007 Block Contracts violate the Appropriations Clause, or that BPA has a legal duty to initiate collection efforts against DSIs.

PPC and other preference customers argue that any erroneous or mistaken expenditure by the Government is a violation of the Appropriations Clause of the United States Constitution, and that the Government has a mandatory duty to initiate collection efforts to recoup such expenditures.[31] These customers cite the following cases as generally supporting their position: *Maryland Small Business Development Financing Authority v. United States*, 4 Cl. Ct. 76 (1983) (when United States pays money illegally or erroneously, it may and must sue to recover such money); *Fansteel Metallurgical Corp. v. United States*, 172 F. Supp. 268, 270 (Ct. Cl. 1959) (an erroneous or illegal payment is a violation of article IV, section 3, clause 2 of the Constitution and the Government has a duty to seek a refund); *Maryland Department Of Human Resources v. United States Department of Agriculture*, 976 F.2d 1462, 1482 (4th Cir. 1992) (where payment violated the Food Stamp Act, the Government must be able to recoup such funds or else funds would be transferred without appropriation of Congress); and *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990), which PPC argues stands for the proposition that the Government must "recover unlawfully made payments, even though those funds were paid from a distinct Treasury fund, similar to the BPA Fund." PPC at 3-4. These cases are inapplicable or can be readily distinguished from the matters under consideration in this remand.

The preference customers rely heavily on a passage from *Fansteel* in which the court states:

> programs-not individual appropriations for individual payments. This Court's creative reliance on constitutional text is nothing but a red herring.

[30] It is worth noting that an Appropriations Clause analysis was found inapplicable to a case involving the Postal Service Fund, a revolving fund available for use by the United States Postal Service that is substantially similar to the BPA Fund. *See* 39 U.S.C. § 2003 (Postal Service Fund). In *Gildor v. United States Postal Service*, 491 F. Supp. 2d 305 (N.D.N.Y. 2007), the court, distinguishing *Richmond*, held that "because there is a Postal Service Fund, distinct from the United States Treasury, the Appropriations Clause does not bar recovery." *Id.* at 311-312 (citing Portmann v. United States, 674 F.2d 1155, 1162-1163 (7th Cir. 1985) (noting USPS payments following estoppel would be "from a self-sustaining fund generated out of the business revenue received" by USPS)).

[31] How the actual amount to be recovered in this case would be measured was expressly reserved for any Phase 2 initiated in these remand proceedings.

> When a payment is erroneously or illegally made it is in direct violation of article IV, section 3, clause 2, of the Constitution. . . . Under these circumstances it is not only lawful but the duty of the Government to sue for a refund thereof.

172 F. Supp. at 270.[32] As support for this apparently sweeping holding, the court cites *United States v. Wurts*, 303 U.S. 414 (1938). But *Wurts*, a case whose principal issue was application of a two-year statute of limitations to a claim by the Government, clearly did not hold that the Government is ever bound, as a matter of law, to seek recovery for mistaken or erroneous overpayments.[33] Rather, the Court merely clarified, in the context of its analysis regarding the statute of limitations issue, that the Government is not, absent a limitation imposed by Congress, barred from seeking recovery, and that "by appropriate action can recover funds which its agents have wrongfully, erroneously, or illegally paid" and that "[n]o statute is necessary to authorize the United States to sue in such a case." 303 U.S. at 415. Far from holding that a legal duty exists to seek recovery, *Wurts* merely clarified that in most cases where an erroneous payment is made by the Government, nothing would *bar* the Government from seeking recovery, and that no specific statutory authority was required for the Government to seek recovery through appropriate action. In other words, *Wurts* and every case cited in *Wurts* addressing this issue hold, or state as dicta, that the Government has a right to seek recovery, not that it has a legal duty to do so.

BPA does not interpret *Fansteel* to mean that any erroneous payment by the Government amounts to a constitutional violation. The plain language of the Fansteel court recognizes as much by noting that no "amendment of the contract exists under which plaintiff could retain the overpayment." *Fansteel*, 172 F. Supp. at 270. Thus, *Fansteel* itself acknowledges that there are situations involving erroneous payments that do not give rise to a constitutional violation, including cases such as the present one, where BPA is contractually prohibited from seeking recovery. Given such explicitly recognized limitations, then, the *Fansteel* court's conclusion (*i.e.*, that the Government was under a duty to seek recovery when the payment was in "direct violation" of Article IV, Section 3, Clause 2) must be read in the context of the facts that were actually before the court. Those facts involved a contract breach by the Government's counterparty where the counterparty did not contest either that the contract had been breached or the quantum of damages that had been caused by that breach. Instead, the contractor's case rested only on threshold issues (*e.g.*, statute of limitations) involving the issue of whether the case could properly be brought before the court as a threshold matter. That factual posture is totally unlike the case here, where no breach of the Block Contracts has occurred and

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[32] While cited in support of an argument regarding the Appropriations Clause, article IV, section 3, clause 2 is not the Appropriations Clause, but rather provides that: "The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; and nothing in this Constitution shall be so construed as to Prejudice and Claims of the United States or of any particular State." In the case of the disposition of federal power in the Pacific Northwest, Congress has acted by delegating such authority to the BPA Administrator, and so there is no violation of the cited clause.

[33] Nor does *Wurts* cite article IV, section 3, clause 2.

there is no contractual basis for determining an "overpayment" amount. *Fansteel* simply does not address the situation at issue in this proceeding, where no contract breach has occurred. Consequently, there is no basis upon which to extrapolate the court's holding to mean that, in this instance, BPA is constitutionally required to seek compensation from its DSI customers.

Fansteel cites generally *Royal Indemnity Co. v. United States*, 313 U.S. 289 (1941), another case heavily relied upon by preference customers. The constitutional analysis in *Royal Indemnity*, however, only addresses the issue of the authority of a Government official to dispose of government property, and the case does not address the question whether there is a constitutional duty to seek recovery of money disbursed, or other property disposed, by an official lacking disbursement or disposal authority. In the DROD, BPA maintained, according to PPC, that it is "not clear that the cases upon which *Fansteel* relied [*i.e., Royal Indemnity*] held that the government is duty bound to seek restitution for payments." PPC at 2 (citing DROD at 25, n.43). PPC argues that BPA's "unconventional interpretation" of *Royal Indemnity* is undermined by other cases. *Id.*

BPA does not believe that its interpretation of *Royal Indemnity* is in any way "unconventional." In *Royal Indemnity* a collector of internal revenue, who had accepted a surety bond filed with him by a taxpayer to accompany his claim for abatement of income tax, consented to termination of all liability upon the bond and surrendered it before the taxpayer's obligation was fully satisfied. The Court noted that the questions for decision were "whether the collector had power to release the obligation of the bond and, if not whether the United States is entitled to interest on the amount of its claim against the surety." *Royal Indemnity*, 313 U.S. at 292. The issue of whether the Government had a duty to seek payment on the bond, inasmuch as the official that released it had no authority to do so, was not before the Court; nor did the Court make any statements to the effect that such a duty would necessarily arise in a case where property of the United States is erroneously surrendered or otherwise disposed of.

It cannot, therefore, be concluded that *Royal Indemnity* held that the Government is duty bound to seek restitution for payments erroneously or illegally made and that it may never waive such right by contract. Even if it did, the holding cannot be applied in this instance, where payments were made pursuant to a contract that was entered into by a Government official exercising contracting authority explicitly conferred upon him by Congress. In the case of the DSIs, the relevant decisions were not made by ministerial functionary like the tax collector. Instead, they were final actions of the BPA Administrator, who is charged with responsibility for implementation of BPA's enabling statutes, including administration of the Bonneville Fund. 16 U.S.C. § 838(i)(a). In short, BPA was correct to point out that *Royal Indemnity* does not provide authority for imposition of a mandatory duty to initiate collection on a claim, and to that extent, the *Fansteel* court's reliance on the case is misplaced.

Other cases cited in comments to support the proposition that the damage waiver provision in the Block Contracts is *per se* illegal, inasmuch as the Government is legally bound to seek recovery of funds erroneously paid, are likewise inapposite. *Wisconsin*

Central Railroad Co. v. United States, 164 U.S. 190 (1886), is cited by several parties for the general principle stated in that case that "parties receiving moneys illegally paid by a public officer are liable *ex aequo et bono* to refund them." *Id.* at 211.[34] But this is nothing more than restating a basic rule of equity jurisprudence that a party that has been unjustly enriched, as a general rule and absent any equitable defenses, will be required *as a matter of equity* to refund the value of the benefits conferred upon him. The case does not hold, or even discuss, the proposition advanced by PPC and others that the Government is obligated *as a matter of law* to seek restitution in every such case, and is therefore as a matter of law prohibited from contractually agreeing to waive any right to do so.

Preference customers also cite *Maryland Small Business Development Financing Authority v. United States*, 4 Cl. Ct. 76 (1983), primarily for its citation to *Fansteel* and the court's statement that "[t]he *Wurts* line of cases unequivocally establishes that when the United States pays money illegally or erroneously, it may and must sue to recover such money." *Id.* at 80. As explained above, the court's observation that the Government "must sue" to recover erroneous or illegal payments is not supported by *Wurts*, the cases cited therein, or any other case cited by preference customers or found by BPA. Again, however, assuming *arguendo* such a duty exists, the case is inapplicable because the liability and the amount owed to the Government in connection with the erroneous payments were not contested. *Id.* at 80.

Finally, PPC cites *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990). PPC argues that *Richmond* supports its argument that payments made by BPA to the smelters under the contracts violated the Appropriations Clause, and therefore BPA is duty bound to seek recovery, and that BPA cannot be estopped from seeking recovery of such payments. In *Richmond*, the petitioner, a Naval retiree, contacted Navy personnel to ascertain whether income from part-time employment would jeopardize his federal annuity payment. He was told, erroneously, by Navy employees (not the Office of Personnel Management) that he would not exceed the cap on outside earnings and would receive his full annuity. Apparently unbeknownst to the Navy employees advising petitioner, the relevant statute had been amended and, due to the amendment, the petitioner's annuity payments would be reduced. The Navy repeatedly provided this misinformation and even provided erroneous forms. When the Office of Personnel Management discontinued the annuity after one year, Richmond filed suit, affirmatively seeking to estop the Government from discontinuing the annuity payment and to disgorge the withheld benefits.

Ultimately, the Supreme Court rejected Richmond's argument, holding that promissory estoppel was not available against the Government if the consequence of its application would be to compel the Government to disburse money without appropriation, since this would violate of the Appropriations Clause. As the Court put it, litigants may not use estoppel "as a basis for money claims against the Government." *Richmond*, 496 U.S. at

[34] *Ex aequo et bono*: according to what is equitable and good. Black's Law Dictionary 600 (8th ed. 2004).

426. However, this central holding in *Richmond* is limited by its facts to cases involving the use of promissory, or affirmative, as opposed to equitable, or defensive, estoppel.[35] Nevertheless, the Ninth Circuit in *United States v. Fowler*, 913 F.2d 1382 (9th Cir. 1990) (citing *Richmond*), held equitable estoppel was not available where the result would be to permit individuals to *retain* public funds that Congress had not appropriated. But *Fowler* is inapplicable here since, as explained below, the payments at issue in this remand do not rise to the level of violations of the Appropriations Clause.[36]

In sum, 1) *Richmond* did not deal with the use of equitable estoppel (defensive), only promissory estoppel (offensive), holding specifically that the United States cannot be compelled through promissory estoppel to make a payment for which there is no appropriation; 2) *Richmond* did not hold that, nor did it even address the question of whether the Government has an affirmative duty to seek restitution in case of an erroneous or illegal payment; and 3) *Richmond* is inapplicable here in that the Appropriations Clause is not implicated, as it was in *Richmond*, because the BPA Administrator's payments to the DSIs was not an *ultra vires* act and the contracts are not void *ab initio*.

Regardless of whether the *Richmond* holding can be extended to bar the use of equitable estoppel against the Government where the result would be to retain money paid without appropriation, the Appropriations Clause is not implicated in this case because, notwithstanding the fact that BPA committed certain legal errors in implementing its authority to serve DSI load, BPA is authorized by statute to serve DSI load, and to incur costs and make expenditures from the BPA Fund associated with that service. The expenditure remains authorized, for purposes of appropriations law, even if a court later finds that the official erred in his implementation of the authorizing statute. In the Appropriations Clause cases cited by PPC and other preference customer groups, payments were made, or would be required to be made, for a purpose or object for which there clearly was no underlying appropriation by Congress.

In this case, the DSI contracts were found inconsistent with BPA statutes because 1) the benefits provided thereunder were based on an incorrect rate, and 2) BPA had failed to

[35] The courts describe promissory estoppel as a sword creating a cause of action, and equitable estoppel as a shield barring a party from raising a defense or instituting an action it otherwise is entitled to undertake. *See, e.g.*, Jablon. v. United States, 657 F.2d 1064 (9th Cir. 1981).

[36]In *United States v. Hatcher*, 922 F.2d 1402 (1991), the Ninth Circuit expressly limited *Fowler* to cases involving payments that had been made, or would be required to be made, in violation of the Appropriations Clause. The *Hatcher* court noted that *Richmond* does not hold equitable estoppel is unavailable in all cases where it is shown the Government would be harmed financially if estoppel were applied. *Id.* at 1410 n.9. *See also* United States v. McAfee, 44 Fed. Appx. (9th Cir. 2002) (applying distinction between offensive and defensive estoppel); Burnside-Ott Aviation Training Cent., Inc. v. United States, 985 F.2d 1574 (Fed. Cir. 1993) (concluding that the Claims Court erred in holding that *Richmond* stands for the proposition that equitable estoppel will not lie against the Government for any monetary claim, and that *Richmond* is limited to claims for the payment of money from the United States Treasury contrary to a statutory appropriation, so that *Richmond*'s holding must be limited to claims of entitlement contrary to statutory appropriations).

demonstrate that offering the contracts was consistent with sound business principles. PPC evidently believes this is enough to invoke *Richmond*. However, the *PNGC* court specifically stated it was not holding the contract itself void, and specifically held that BPA had the authority to serve DSI load, so long as such service was undertaken consistent with its holdings regarding the appropriate rate for DSI service, and so long as BPA found service was consistent with sound business principles.

There are no Appropriations Clause implications in this case inasmuch as Congress has authorized service to DSIs and has appropriated funds, through the creation of the Bonneville Fund, to effectuate such service, so that the BPA Administrator was acting within the scope of his authority in making the payments, even if they were made based on a mistake of law. Therefore, *Richmond* and its progeny are inapplicable because under these circumstances the Appropriations Clause is not implicated, let alone violated.[37]

In sum, BPA is not persuaded by arguments that there has been a violation of the Appropriations Clause in this instance based on cases cited by preference customers. In the following section, BPA identifies case law that supports its conclusion that the Appropriations Clause is not implicated in this case.

C. Additional case law supports the conclusion that the contracts with the DSIs are not void *ab initio*, the Administrator's expenditures in support of those contracts are not *ultra vires*, and, therefore, the Appropriations Clause is not implicated.

BPA has repeatedly cited the court's statements that it was not holding that the DSI contracts are void *ab initio* and therefore the issue is whether BPA "is permitted to seek restitution, not whether it is 'required to do so'." PPC argues that "BPA's reliance on the *PNGC I* opinion to escape its duty is unavailing." PPC at 5. First, PPC suggests that the court was not aware of, and did not consider, the cases and statutes cited by PPC for the proposition that BPA has a duty to recover DSI payments: "The Court did not consider these provisions of law when deciding the *PNGC I* case—indeed the issues were not briefed in that case, which dealt with the legality of the DSIs' contracts." *Id.* PPC also submits that the above referenced statements are "not the Court's characterization of the law":

> [T]he statements of the Court upon which BPA relies are not the Court's characterization of the law. Rather, the Court was describing that it did not have before it the agency's interpretation of the waiver clause or severability clause in the DSI contracts, and thus it could not judge

[37] Contrary to PPC's implication otherwise, and regardless of whether *Richmond* would otherwise preclude the use of estoppel against BPA in this case, *Richmond* does not hold that the Government is legally bound to seek repayment in the event of an erroneous or illegal payment by the Government that also violates the Appropriations Clause. That question was not before the court, because estoppel was being invoked affirmatively to compel the Government to make a payment, rather than defensively to preclude the Government from recovering a payment.

> whether the agency's interpretation comported with the law. A more straightforward reading of the Court's statement would be that the Court was directing BPA to decide, in the first instance, whether it thought it was permitted under the contracts to recover from the DSIs, and that this determination would then be judged against the relevant law on the topic (including the law described above).

Id. BPA does not agree and believes the statements were consistent with the court's understanding of the law in this area. Nonetheless, since the issue was not specifically before the court, BPA has undertaken to address the issue fully under each of the two potential theories raised by the preference customers, *i.e.*, that either the contract was rendered void *ab initio* by the legal errors identified by the court, or the Administrator's decision to enter into the DSI contracts was *ultra vires*. Neither theory is supportable and the court's original finding that the contracts are not void *ab initio* is a correct conclusion in light of the relevant legal principles and case law.

Preference customer arguments appear to be based on the conclusion that any action undertaken by an agency that is based on a mistake of law or fact renders such action void *ab initio,* or renders the action of a government agent *ultra vires*. PPC concludes from this that:

> [T]he obvious course of action for BPA is to pursue a recovery of the funds it has paid out unlawfully. Good policy and adherence to the law requires BPA to do so; an apathetic or intentional approach of leaving the funds with the DSIs runs headlong into fundamental requirements placed on the executive branch. . . . BPA, without question, has a duty to diligently seek to recover money unlawfully paid.

PPC at 2. Other preference customer groups make similar comments. NRU at 1 (BPA has an affirmative duty to collect the monies unlawfully paid); PNGC at 2 (BPA is bound by a statutory mandate to act in accordance with sound business principles and must recover the "unlawful subsidy payments" from the aluminum DSIs); ICNU at 1 (BPA should "focus on how to ensure that the DSIs are not able to retain illegal payments.").

These arguments, however, fail to address the fundamental issues surrounding the question of when the acts of an agency head are *ultra vires* due to a legal defect, when a contract should be declared void *ab initio*, and when an expenditure constitutes a violation of the Appropriations Clause of the United States Constitution. These issues cannot be addressed without examination of relevant law, including the statutes under which an agency operates. It is simply not true, as suggested by preference customers, that: 1) any illegality renders an action *ultra vires*; 2) any contract made under a mistake of law is necessarily void *ab initio*; and 3) any expenditure made in conjunction therewith violates the Appropriations Clause, giving rise to a mandatory duty to initiate recovery actions. The actual status of the law, as described more fully below, is that 1) acts by agency heads, including the BPA Administrator, are *ultra vires* only if there is no legal authorization for the underlying action taken; 2) contracts executed by the BPA

Administrator are not necessarily void *ab initio* simply because a legally authorized act was implemented in a manner which is in some respect factually or legally erroneous; and 3) there is no violation of the Appropriations Clause where an official is authorized by statute to make expenditures with respect to a purpose, program, or object, notwithstanding that an actual expenditure made with respect to such purpose, program, or object was made pursuant to a mistake of law or fact.

As a consequence, BPA believes that the correct analysis is that, if an official, acting within the scope of his authority has incurred an obligation or made a payment for a purpose, program, or object for which Congress has made an appropriation, a later finding that the payment was made under a mistake or law or fact does not mean the Appropriations Clause has been violated.

1. Case law does not support preference customers' arguments that the DSI contracts are void ab initio.

PNGC I explicitly stated that it was not holding that the DSI contracts were void *ab initio*. Nonetheless, preference customers appear to believe that, once the court has been alerted to the appropriations law cases, it will realize that its earlier view was mistaken and nullify the contracts in their entirety. BPA believes that a complete analysis of the court's statements in *PNGC I* and a full examination of relevant case law prove otherwise.

In rejecting BPA's draft finding that the damage waiver provision is binding and enforceable, PPC essentially argues that the damage waiver cannot be preserved because the contract is void *ab initio* in that the provision cannot be separated from the illegal purpose of the contract and would implement the deal that the court found unlawful. PPC at 7. In essence, PPC is arguing that any legal error renders a contract void *ab initio*. In support of this line of argument, PPC cites the Restatement (Second) of Contracts § 183, cmt. a. (1981) for the proposition that severing one part of an agreement from another part is allowable only when the severed provision "does not materially advance the improper purpose." In other words, it is apparently the position of preference customers that identification of any "improper purpose" (in this case, any legal error) nullifies the entire contract from its inception, and no issues can remain with respect to severability and enforceability of remaining terms that have not been declared erroneous or improper.

However, this line of argument is fundamentally wrong. First, it turns the court's language on its head. As noted, the court expressly found that notwithstanding its invalidation of the monetization formula that "[w]e do not hold that the contracts are void 'as if no[ne] . . . ever existed.'" *PNGC I*, 580 F.3d at 827 (ellipses in original). Thus, the court recognized that not every legal error should result in nullification of the contract and that, in some circumstances, the bargain agreed to by the parties should be enforced in spite of legal errors. The same conclusion applies to the Port Townsend/Clallam contracts.

Second, it is not clear that PPC's (and other preference customers') reliance on the above referenced section from the Restatement is appropriate under the circumstances. First, BPA disagrees that monies were spent in pursuit of an "improper purpose." As noted elsewhere, such expenditures are authorized by Congressional language creating the Bonneville Fund, and BPA believes the record supports the conclusion that BPA would have physically served DSI load at the IP rate, within the same economic parameters established under the monetized Block Contracts, and that such action would have been consistent with BPA's business interests. Clearly, as noted above, the court explicitly affirmed BPA's authority to sell power to the DSIs. The fact that legal errors were committed in pursuing that objective under the Block Contracts as originally conceived and implemented does not convert the basic purpose of BPA's DSI activities into an "improper" one.[38]

Third, BPA believes that the view of the court in this instance, consistent with applicable legal standards, is that while legal errors were made, they constituted errors in the implementation of authority, not actions that are totally outside the scope of the Administrator's authority. The Federal Circuit, which is responsible for appellate review of cases emanating from the Court of Federal Claims, hears more government contract claims than any other court and has addressed the legal consequences flowing from this distinction. For example, *United States v. Amdahl*, 786 F.2d 387 (Fed. Cir. 1986), deals authoritatively and comprehensively with situations where contractors with the Government have been awarded a contract and performed thereunder, only to have their contractual expectations upset by a successful bid protest which reveals some irregularity in the award process, a situation analogous to the situation here. In its analysis of the bid protest at issue in *Amdahl*, the court cites at length to the analysis and holding in *John Reiner & Co. v. United States*, 325 F.2d 438 (Ct. Cl. 1963). In *Reiner*, a contractor sued the Government on the ground of breach of contract for cancelling its contract at the behest of the Comptroller General following a protest. The *Reiner* contractor was neither the cause of, nor aware of the illegality in the award. The Reiner court reasoned that:

> [W]here a problem of validity of the invitation or responsiveness of the accepted bid arise after the award, the court should ordinarily impose the binding stamp of nullity only when the illegality is plain. If the contracting officer has viewed the award as lawful, and it is reasonable to take that position under the legislation and regulations, the court should normally follow suit. Any other course could place the contractor in an unfortunate dilemma. If he questions the award and refuses to accept it because of his own doubts as to possible illegality, the contracting officer could forfeit his bid bond for refusing to enter into the contract. The full risk of an adverse decision on validity would then rest on the bidder. If he [i.e., the contractor] accedes to the contracting officer and commences performance of the contract, a subsequent holding of non-enforceability

[38] In its cross-comments, Alcoa makes a similar point, noting that the "improper purpose" at issue in *PNGC I* was BPA's decision to monetize the power sale to Alcoa based on a rate other than the IP rate (*i.e.* the FPS rate) not, as PPC suggests, service to Alcoa in general because the Ninth Circuit has twice upheld BPA's authority to do so. Alcoa at 7.

> would lead to denial of all recovery under the agreement even though the issue of legality is very close . . . . It is therefore just to the contractor, as well as to the Government, to give him the benefit of reasonable doubts and to uphold the award unless its invalidity is clear.

Reiner, 325 F.2d 438, 440. The court then notes that after determining that the invalidity of the contract award was not plain at the time it was executed, the *Reiner* court held "that the award to plaintiff must be deemed lawful." *Id.* at 442.

Amdahl also favorably quotes a Comptroller General opinion:

> In determining whether an award is plainly or palpably illegal, we believe that if the award was made contrary to statutory or regulatory requirements because of some action or statement by the contractor, or if it was on direct notice that the procedures being followed were violative of such requirements, then the award may be canceled without liability to the Government except to the extent recovery may be had on the basis of *quantum meruit.* On the other hand, *if the contractor did not contribute to the mistake resulting in the award and was not on direct notice before award that the procedures being followed were wrong, the award should not be considered plainly or palpably illegal*, and the contract may only be terminated for the convenience of the Government [resulting in a damage award to the contractor].

52 Comp. Gen. 214, 218 (1972) (emphasis added). Similar reasoning has been applied where a contract was undertaken in violation of a specific statutory appropriations limitation. In *American Telephone & Telegraph Co. v. United States (AT&T),* 177 F.3d 1368 (Fed. Cir. 1999), the court was reviewing a contract by and between the United States and AT&T. The central legal issue before the court was whether the contract was subject to an express appropriations limitation and, if so, whether failure to comply with that limitation rendered the contract void *ab initio*. After holding that the appropriations limitation did in fact apply to AT&T's contract, the court then held that, although the Government failed to abide by the limitation, the contract was not void *ab initio. Id.* Instead, the court held that AT&T, having fully performed on the illegal contract, could nevertheless recover what it was owed for its performance under a theory of implied contract or reformation, and held that:

> When a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously sustained the contract, reformed it to correct the illegal term, or allowed recovery under an implied contract theory; the courts have not, however, simply declared the contract void *ab initio*.

AT&T, 177 F.3d at 1376 (citing LaBarge Products v. West, 46 F.3d 1547, 1552-53 (Fed. Cir.1995) (if breach of law is inherent in writing of government contract, then reformation is available to contractor despite its initial adherence to contract provision later shown to be illegal); Beta Systems, Inc. v. United States, 838 F.2d 1179, 1185-86 (Fed. Cir. 1988) (if Government violated applicable regulations in setting economic index incorporated into contract, the Government cannot by law benefit from it and contract must be reformed)).

In the case of the DSI contracts, there was legal uncertainty during the course of negotiations, based on the discretionary nature of DSI contracts and the legal standards that would ultimately apply to such sales. BPA developed a construct that it believed to be legal at the time. The Northwest Power Act states only that, after expiration of the initial mandatory contract offers to DSIs, further sales are "authorized." 16 U.S.C. § 839c(d)(1)(A)-(B) (2006). The *PNGC* court has now clarified that discretionary sales to the DSIs must, pursuant to the Northwest Power Act, be offered first at the IP rate, and only after BPA has made a finding that such sales are consistent with sound business principles. However, at the time BPA designed the service construct under the 2007 Block Contracts, it believed it had greater flexibility regarding the terms and conditions under which it could make such sales, and that the construct was consistent with its authorities. The DSIs did not have any better knowledge than BPA, at the time, regarding how the courts would ultimately interpret the law as it applied to this new world of discretionary DSI sales.[39] The DSIs did nothing to advance the legal mistakes made by BPA, or to unfairly leverage their position. In fact, they could not have done so, because the Administrator had determined that no offer other than the one developed by BPA was on the table, and no further options would be forthcoming.

In sum, the Administrator was acting upon his statutory authority to enter into contracts with the DSIs and his authority, pursuant to explicit appropriations language to make expenditures from the Bonneville Fund for the purpose of marketing power. There was no fraud, duress, inducement, or other conduct on the part of the DSIs that might otherwise undermine the legitimacy of the Administrator's actions. Thus, there is absolutely no basis to conclude that the contracts in question are void *ab initio* or that the payments made thereunder violate the Appropriations Clause of the United States Constitution.

[39] Nor did BPA's public preference customers, whose main argument that any DSI service resulting in higher preference customer rates is illegal has been rejected by the court.

***2. To the extent preference customer arguments are based on an ultra vires theory, the arguments do not reflect a correct understanding of when a government official's acts are beyond the scope of his authority*.**

As the cases discussed below attest, the concept of *ultra vires* is not as clear-cut as preference customers have argued. A finding by a court that a legal error has been committed does not inexorably lead to the conclusion that a government officer has acted *ultra vires*. The Supreme Court's holdings and analysis in *Larson v. Domestic & Foreign Commerce Corp*., 337 U.S. 682 (1949), for example, support BPA's conclusion that the DSI contracts are not based on an *ultra vires* act. *Larson* is a case about sovereign immunity, and analyzes under what circumstances a suit brought against a government official is actually a suit against the United States, specifically what actions by an official may be held *ultra vires* his delegated authority, in which case there can be no suit against the United States. In *Larson*, the respondent sued the Administrator of the War Assets Administration (WAA), seeking to have the Administrator deliver coal to it pursuant to an agreement with the WAA. The question was whether the suit was really against the United States, and whether sovereign immunity had been waived for such a suit to be brought against the United States. The respondent argued the suit was not against the United States because the Administrator had acted "illegally" in not delivering the coal pursuant to the agreement, and therefore acted *ultra vires* his authorities.

The Court noted there were basically two circumstances under which an official can be viewed to have acted *ultra vires* his authorities: if he acts "unconstitutionally" or pursuant to an unconstitutional statute, or if he acts beyond his delegated authorities – in each case his actions are considered *ultra vires* his authorities, and are therefore his own actions, not those of the sovereign, and are subject to specific relief. The Court noted plaintiff had not alleged either circumstance pertained; *i.e.*, there was no claim the WAA was acting unconstitutionally or pursuant to an unconstitutional statute, nor any "allegation of a limitation on the Administrator's delegated power to refuse shipment [of coal] in cases in which he believed the United States was not obligated to deliver." 337 U.S. at 691. The Court held it was not enough that the Administrator may have acted "illegally" with respect to his obligations under the agreement between the parties, but that even if he had, that fact did not mean the Administrator lacked delegated power, and that in fact the Administrator was "empowered by the sovereign to administer a general sales program encompassing the negotiation of contracts, the shipment of goods, and the receipt of payment." *Id.* The Court noted that in such a case the issue is not the "correctness or incorrectness of the . . . decision under general law but simply the power of the official, under the statute, to make a decision at all." *Id.* at 692 n.12.

In rejecting plaintiff's argument that the Administrator's action was *ultra vires,* the court wrote:

> It is argued that an officer given the power to make decisions is only given the power to make correct decisions. If his decisions are not correct, then his action based on those decisions is beyond his authority and not the action of the sovereign. *There is no warrant for such contention in cases*

> *in which the decision made by the officer does not relate to the terms of statutory authority*. Certainly the jurisdiction of the court to decide a case does not disappear if its decision on the merits is wrong. *And we have heretofore rejected the argument that official action is invalid if based on an incorrect decision as to law or fact, if the officer making the decision was empowered to do so*.

Id. at 695 (emphasis added). In this instance, preference customers essentially argue that the *PNGC* cases were fundamentally about the "terms of statutory authority" and, would presumably therefore argue, unlike *Larson*. Certainly, there are factual distinctions between this situation and *Larson.* BPA believes, however, that the fundamental principle involved in *Larson* is applicable here. Like *Larson*, where the WAA Administrator was authorized by Congress to administer a general sales program, there can be little dispute regarding the authority of the BPA Administrator to provide service to DSI customers and incur costs (and make expenditures from the BPA Fund). Thus, the Administrator was acting within the scope of his lawful authority, and the fact that he implemented that authority in a manner that was later determined to be legally erroneous does not render his actions *ultra vires*, which goes to the principal holding in *Larson*.

In fact, scope of authority questions turn on whether the official was empowered to do what he did, *i.e.*, whether, even if he acted erroneously, the action was within the scope of his delegated authority. *See* United States v. Yakima Tribal Court, 806 F.2d 853 (9th Cir. 1986), *cert. denied*, 481 U.S. 1069 (1987) (citing Pennhurst State Sch. v. Halderman, 465 U.S. 89 (1984) (holding *ultra vires* claims rest on the official's lack of delegated authority)). In *Yakima*, an official of the Bureau of Indian Affairs (BIA) undertook moving an irrigation canal on reservation land without first complying with certain federal rights-of-way statutes applicable to Indian trust lands.[40] There was no question the official was authorized to act with respect to irrigation canals on the reservation, but his actions in this case were not fully consistent with his statutory authorities and obligations because not all procedural requirements had been followed. The court, citing *Larson*, held that the official had not acted *ultra vires* even though he "may have violated statutes and regulations regarding owner consent to right-of-way changes" and that an action is *ultra vires*, and results in a divestiture of sovereign immunity, only where an official acts "completely outside his governmental authority." *Yakima*, 806 F.2d at 859-60. Apparently recognizing that the facts presented (as in our case) were somewhat different than those in *Larson* (where the alleged *ultra vires* act concerned the officer's interpretation and action under contract, not his statutory authority) the court went on to state:

> We need not decide in this case at what point a violation of statute or regulation is so inconsistent with the agent's authority that he divests himself of sovereign immunity. We do hold that, unlike constitutional violations, there is no per se divestiture of sovereign immunity when

[40] The plaintiffs argued the official had acted *ultra vires* his authority because he had not fully complied with the applicable statutes, and therefore sovereign immunity could not be invoked to keep the dispute out of the tribal courts.

> statutes or regulations are violated while an agent is pursuing his authorized duties.

Id.[41]

These cases underscore the limited application of an *ultra vires* finding to instances where an officer or agent of the Government has acted completely outside his delegated authority.[42] That is not the situation with respect to DSI contracts. The fact that the BPA Administrator misconstrued the statutory requirements regarding service to DSI customers does not mean service based on that misconstruction is *ultra vires* where service to DSI customers is otherwise within his scope of authority to determine.[43]

3. Preference customers are incorrect in concluding BPA has a statutory or regulatory duty to seek recovery from the DSIs.

Preference customers argue, in addition to the constitutional basis establishing BPA's duty to recover unlawfully paid funds, that federal statutes also place this duty on BPA. Specifically, PPC cites 31 U.S.C. § 3711(a)(1) (part of the Debt Collection Improvement Act of 1996, referred to hereafter as "Debt Collection Act" or "Act"), as providing that the "head of an executive . . . agency shall try to collect a claim of the United States Government for money or property arising out of activities of, or referred to, the agency." PPC at 5; *see also* NRU at 1. Preference customers' reliance on this provision for the proposition that BPA is legally bound to seek repayment by the DSIs in this case is misplaced.

The Debt Collection Act specifically, assumes the existence of a claim. It does not address, in any manner, the particular process by which agency heads should address the initial issue of whether a claim exists. Nonetheless, 31 U.S.C. § 3701 provides that in subchapter II of chapter 37, of which 31 U.S.C. § 3711 is a part, "the term 'claim' or 'debt' means any amount of funds or property that has been determined by an appropriate

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41 *See also* Alaska v. Babbitt, 67 F.3d 864 (9th Cir. 1995) (action is not *ultra vires* simply because it "is arguably a mistake of fact or law"); Sahaviriya Steel Industries Public Co. v. United States, 601 F. Supp. 2d 1355 (Ct. Int'l Trade 2009) (relevant question for purposes of determining whether an act is *ultra vires* is even if the agency acted erroneously, was it within the scope of its delegated power to act at all); Whaley v. County of Saginaw, 941 F. Supp. 1483, 1495 (E.D. Mich. 1996) (an *ultra vires* act is one that "the governmental agency lacks legal authority to perform in any manner").

42 While these cases often involve the question of whether an act divests the government of sovereign immunity in the tort arena, the analysis and conclusions apply equally to the question presented here regarding at what point a government agency has acted so far outside of its appropriation authority that a violation of the Appropriations Clause has occurred.

43 Arguably, this analysis is especially germane to the case at hand, inasmuch as BPA continues to be called upon to interpret the parameters of its authorities with respect to discretionary, as opposed to mandatory, sales to the DSIs in light of the *PNGC* decisions. In fact, as noted earlier, BPA's latest contracts with Alcoa and Port Townsend have been challenged by preference customers and in the case of the Alcoa contract, by Alcoa itself.

official of the Federal Government to be owed to the United States by a person, organization, or entity other than another Federal agency." It goes on to provide that "A claim includes, without limitation . . . (G) other amounts of money or property owed to the Government." The primary purpose of this remand proceeding is to determine *whether* there is a viable claim to pursue in the first instance. BPA has determined that no such claim exists and, as a result, there is no "claim" and the above referenced collection standards are inapplicable.

Moreover, DOJ regulations implementing 31 U.S.C. § 3711 indicate that the purported existence of a claim is not the end of the analysis and agencies must thoroughly evaluate the merits of pursuing a claim, even where an agency believes one exists. In that respect, the statute counsels that agency heads be cautious and thorough in their determinations. The DOJ implementing regulations, for example, set forth the standards for compromising claims.[44] Among numerous other reasons for effecting a compromise, the regulations state:

> If there is significant doubt concerning the Government's ability to prove its case in court for the full amount claimed, either because of the legal issues involved or because of a bona fide dispute as to the facts, then such cases should fairly reflect the probabilities of successful prosecution to judgment, with due regard given to the availability of witnesses and other evidentiary support for the Government's claim.

31 C.F.R. § 902.2(d). BPA believes its approach to responding to the issues present here is consistent with the statutes and regulations cited by preference customers.

BPA believes its approach is also consistent with its own broad contracting and settlement authorities. Section 2(f) of the Bonneville Project Act provides that subject only to the provisions of that Act, the BPA Administrator "is authorized to enter into such contracts, agreements, and arrangements, including the amendment, modification, adjustment, or cancellation thereof and the compromise or final settlement of any claim arising thereunder . . . as he may deem necessary." 16 U.S.C. § 832a(f). Section 9(a) of the Northwest Power Act reaffirmed and updated this authority, providing "Subject to the provisions of this chapter, the Administrator is authorized to contract in accordance with section 2(f) of the Bonneville Project Act of 1937." 16 U.S.C. § 839f(a). As observed by Port Townsend in its cross-comments:

> BPA is not required to pursue any claim a third party may argue it has, regardless of BPA's evaluations of the merits of the claim. BPA is entitled

[44] The authority to compromise provided by these regulations is limited to claims that do not exceed $100,000, so by their terms the regulations are not applicable in this situation. 31 C.F.R. § 902.1. Compromises above that threshold amount must be approved by DOJ. Section 2(f) of the Bonneville Project Act (incorporated by reference in the Northwest Power Act) contains no such monetary limitation. Nor does the statute require DOJ approval of compromises and settlements unless the matter has been referred to, and accepted by, DOJ for litigation. However, while the regulations do not appear to apply to this situation by their own force, there is no impediment to BPA consulting the regulations for guidance with respect to general government policies on the settlement and compromise of claims.

> to make a reasoned decision as to whether its chances of success with a claim justifies the legal and other costs of pursuing the claim. Were the situation otherwise, BPA would be legally prohibited from compromising and settling any claim. Moreover, BPA would be required to pursue all possible claims, without regard to likelihood of success, arising out of its commercial power contracts; such a policy would make BPA a very unattractive contract counterparty indeed. BPA should exercise such reasoned decision-making here.

Port Townsendcx at 2. This view is consistent with BPA's contracting, claim, and settlement authorities in sections 2(f) of the Bonneville Project Act and 9(a) of the Northwest Power Act.

PPC and NRU also reference the Federal Claims Collections Standards, which state in part that federal agencies shall "aggressively collect all debts arising out of activities of . . . that agency." 31 C.F.R. § 901.1(a).[45] PPC and NRU conclude that these regulations impose a legal duty on BPA to seek recovery from the DSIs in this case. PPC at 5; NRU at 1. But PPC's argument that the Debt Collection Act and its implementing regulations compel BPA to undertake recovery actions against the DSIs is not consistent with the purposes of the Act or the regulations. If anything, the Act requires an agency head to carefully evaluate whether a valid claim exists and if so, whether collection actions will bear fruit in excess of the costs associated with such collection efforts. BPA has undertaken to perform such an evaluation in this remand proceeding.

Final Decision (Issues 1.A and 1.B)

The invalid rate provisions in the Block Contracts are severable, leaving the remainder of the contracts intact, including the damage waiver provision. While the discussion of the damage waiver provision in the 2006 ROD focused on its application where the aluminum company ceased operations following a court decision voiding the Block Contract, it was not BPA's intent to limit the application of the waiver provision to that circumstance. BPA's intent that the waiver provision would have broad application is expressed unambiguously by the plain language of the waiver provision itself. It is reasonable to conclude, as a matter of contract law, that the parties intended the damage waiver provision to be binding and enforceable in exactly this type of situation and that it should therefore remain binding and enforceable. It follows that, in spite of arguments posed by preference customers, both BPA and the DSIs should not be deprived of the protection of the damage waiver provision, which the parties agreed was a proper allocation of the risk that the contract was legally defective.

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[45]PPC and NRU mistakenly cite and quote 4 C.F.R. § 102.1(a), but these regulations were revised and recodified in late 2000 pursuant to the Debt Collection Act. The regulations are now codified at 31 C.F.R. §§ 900-904. *See* Federal Claims Collection Standards, 65 Fed. Reg. 70,390 (Nov. 22, 2000). The replacement for 4 C.F.R. § 102.1(a) is 31 C.F.R. § 901.1(a).

BPA is not persuaded by the preference customers' arguments that BPA has a legal duty to seek recovery from the DSIs for payments made pursuant to the Block Contracts which renders the damage waiver provision ineffective. Supreme Court case law supports the conclusion that the United States may by contract allocate to itself financial risk associated with changes in the law, or other subsequent events, that impair the Government's ability to perform its contractual obligations. Case law cited by preference customers does not support the proposition that BPA is legally bound to seek recovery from the DSIs in this case, nor do the payments made by BPA to the aluminum company DSIs constitute a violation of the Appropriations Clause, because the BPA Administrator was acting within the scope of his authority in entering into the Block Contracts.

Based on the foregoing, BPA concludes that the damage waiver provision is enforceable by and against BPA. Therefore, BPA is not permitted to seek additional payments from Alcoa or CFAC, nor is Alcoa or CFAC permitted to seek additional payments from BPA.

Issue 2: **Is BPA's decision to not seek refunds from the DSIs inconsistent with BPA's separate decision to recover overpayments under the 2000 Residential Exchange Program Settlement Agreements?**

Short Answer

No. BPA's decision to seek refunds or not is dependent upon the particular legal and factual circumstances of each case. As explained more fully below, the legal and factual circumstances that led BPA to recover certain payments in connection with the REP Settlement Agreements do not exist in this case. In *Portland General Electric v. Bonneville Power Administration (PGE)*, 501 F.3d 1009 (9th Cir. 2007), the court held that BPA exceeded its settlement authority when it entered the REP Settlement Agreements. In reaching this conclusion, the court did not affirm BPA's authority to enforce any aspect of the REP Settlement Agreements, and offered no indication that any provision was severable from the agreement. As a consequence of the court's ruling, BPA concluded that the REP Settlement Agreements were void *ab initio*, and proceeded to conduct a remedial proceeding to determine whether and to what extent preference customers had been overcharged as a result of the REP Settlement Agreements.

No such remedial analysis, however, is either commanded or warranted in the context of the DSI Block Contracts. First, the court in *PNGC I* affirmed BPA's authority to sell to the DSIs, and in doing so, expressly acknowledged that portions of the Block Contracts (such as the waiver provision) may be severable from the unlawful portions of the agreements. *PNGC I*, 550 F.3d at 881-82. Second, even if the court's opinion in *PNGC I* could be construed as invalidating the Block Contracts, BPA's decision to not seek repayments would be reasonable because of the type of transaction at issue. This decision is in no way incompatible with BPA's decision to recover overpayments in the *PGE* case because the REP Settlement Agreements and the Block Contracts are fundamentally different types of transactions. Also, as discussed more fully in this ROD, the administrative record supports a conclusion that, in the absence of the Block Contracts, it would have been in BPA's long-term business interest to provide physically delivered power to the DSIs under the same economic parameters contained in the Block Contracts, and that BPA would have done so.

Discussion

A. The 2000 REP Settlement Agreements were void.

In *PGE*, the court invalidated the 2000 Residential Exchange Program Settlement Agreement (REP Settlement Agreements) by and between BPA and its regional investor-owned utility customers. In *Golden Northwest Aluminum, Inc. v. Bonneville Power Administration (GNA)*, 501 F.3d 1037 (9th Cir. 2007), a companion case to *PGE*, the court held that BPA impermissibly allocated certain costs associated with the REP Settlement Agreements to its public preference customers' rates in contravention of section 7(b)(2) of the Northwest Power Act. *Id.* at 1053. The court remanded BPA's WP-02 Wholesale Power Rates with instruction to "set rates in accordance with this opinion." *Id.*

In response to the court's opinions, BPA concluded that some manner of repayment or set-off was required with respect to the preference customers' rates because it viewed "the logic and language of [*PGE* and *GNA*] as requiring retroactive relief for overcharges [to other customers rates] during the FY 2002-2006 period, based primarily on the conclusion that the remand order cannot be fully satisfied without rectifying what the Court itself describes as a 'plain violation' of the law." *See 2007 Supplemental Wholesale Power Rate Case Final Record of Decision* (WP-07S ROD), WP-07-A-05, p.22 (conformed copy 1/30/2009). In reaching this decision, BPA considered, but ultimately rejected, the IOUs' arguments that a clause in the REP Settlement Agreements prohibiting BPA from recovering any payments made under the agreement was enforceable. *Id.* at 178. As explained further in the WP-07S ROD:

> [B]ecause the Court [in *PGE*] held that BPA acted beyond the scope of its statutory authority when it executed the 2000 REP Settlement Agreements and the Court did not carve out any exception with respect to the invalidity clause or any other clause, *BPA believes the 2000 REP Settlement Agreements are invalid in their entirety. As a result, the invalidity clause is also invalid and cannot be used as a shield to prohibit BPA from recovering 2000 REP Settlement Agreement benefits from the IOUs through the Lookback proposal*.

WP-07S ROD at 178 (emphasis added). This language makes clear that the court's finding that BPA lacked authority to enter into the REP Settlement Agreements was central to BPA's decision to not enforce the "invalidity" clause in the REP Settlement Agreements and to seek recovery. This conclusion was bolstered by the fact that the court made no statements regarding the severability of any provision of the agreement. These particular aspects of the court's decision in PGE led BPA to conclude that the proper course of action was to treat the entire REP Settlement Agreement, including the invalidity clause, as void and unenforceable, and to conduct a Lookback proceeding.

In the instant case, however, the court's decision in *PNGC I* does not compel a finding by BPA that the entirety of the Block Contracts are invalid or that restitution is necessary. The court in *PNGC I* specifically stated it was not holding that the Block Contracts were void in their entirety, and held that BPA has the authority to enter into power sales agreements with the DSIs such as the Block Contracts, in the event that such sales are otherwise consistent with BPA's statutory obligations. 580 F.3d at 827. Therefore, unlike in *PGE*, there is no reason for BPA to conclude that the 2007 DSI Block Contracts were void *ab initio*, and that the damages waiver provisions are of no force or effect.

In addition, as noted above, in the event only certain obligations or provisions in a contract violate a statute, or are otherwise illegal, if such obligations or provisions are severable courts will enforce the remaining legal obligations of the parties. *See* Kelly v. Kosuga, 358 U.S. 516 (1959); Cal. Pac. Bank v. Small Bus. Admin., 557 F.2d 218 (9th Cir. 1977). *PNGC I* is consistent with this principle of contract enforcement. Here, BPA had the authority to enter into the Block Contracts, and the court essentially held that those contracts could be modified to give effect to the remaining legal obligations of the parties, including the damage waiver provision. 580 F.3d at 827.

B. Even assuming *arguendo* that the Block Contracts were void *ab initio*, they are distinguishable from the REP Settlement Agreements for purposes of the Lookback analysis.

Even assuming *arguendo* that the 2007 Block Contracts were void in their entirety so that the damage waiver provision were of no force or effect, a different result than in the case of the REP Settlement Agreements may be required as a consequence of the fundamentally different nature of the REP when compared to BPA's sale of surplus power to the DSIs under the Block Contracts.

Fundamentally, the REP is a statutory entitlement program in which the residential and small farm customers of Pacific Northwest utilities receive a share of the benefits generated by the Federal Columbia River Power System. As noted previously, section 5(c) of the Northwest Power Act established the REP, which prescribes the manner of determining REP benefits. 16 U.S.C. §§ 839c(c)(1) – 839c(c)(7)(C).

Although the REP is described as an exchange of power, no power actually flows or is exchanged; rather, the "exchange" is a paper transaction under which BPA calculates benefits, if any, based on the difference between BPA's PF Exchange rate and the average system cost (ASC) of an exchanging utility's resources. If, pursuant to the Act, FERC regulations, and BPA's rules, BPA determines that a utility's ASC exceeds BPA's PF Exchange rate, BPA pays the utility the calculated amount of REP benefits (which are passed through directly to the utility's residential and small farm customers). Thus, REP purchases and exchange sales are mandatory, and are akin to an entitlement program. As such, the REP is best characterized as an exercise of the regulatory or sovereign function of the United States. Moreover, BPA's preference customers are protected from certain costs of the REP being included in their rates, through the rate test established by section 7(b)(2) of the Northwest Power Act.

By contrast, the sales of surplus power by BPA, including such sales to the DSIs, while also subject to certain statutory limitations and other requirements, are fundamentally different from the REP in that they are commercial and discretionary. The essential terms and conditions of such sales – again subject to certain statutory limitations and conditions – are generally negotiable and, to a large extent, dictated by the wholesale power market. As such, a BPA sale of surplus energy is best characterized as an exercise of the proprietary function of the United States.

The distinction between BPA's sovereign role as a regulatory administrator of the REP, and its commercial role as a marketer of federal power (in this case surplus power) is relevant in evaluating BPA's ability to seek restitution from, respectively, the investor-owned utilities under the REP Settlement Agreements and the DSIs under the 2007 Block Contracts. As a general matter, and as discussed below, in cases where the Government, acting in its sovereign capacity, has wrongfully conferred a benefit upon a third party, or acted in some manner in relation to such party that is beyond its authority to act - even in a case where that party has detrimentally relied upon the Government's *ultra vires* actions, determinations, or representations - it is exceedingly difficult for such party to successfully claim that the Government should be estopped from, for example, seeking to recover such benefits. *See, e.g.*, REW Enterprises Inc. v. Premier Bank, N.A., 49 F.3d 163 (5th Cir. 1995) (federal land bank acted in governmental, rather than proprietary, capacity when it committed *ultra vires* act of honoring letter of credit, and, thus, purported exception allowing estoppel against the Government with regard to activities undertaken primarily for commercial benefit of the Government did not apply).

In the REP Lookback, BPA undertook to administratively recover the illegal REP payments after it determined that the damage waiver provision in the REP Settlement Agreement was void, applying the general rule that courts will not enforce an illegal contract where to do so would sanction the very type of bargain which a statute outlaws. De Vera v. Blaz, 851 F.2d 294 (9th Cir. 1988). Because BPA exercises a sovereign or quasi-sovereign function in implementing and administering the REP, it is highly unlikely the investor-owned utilities could have successfully argued that BPA should be estopped from undertaking the Lookback.[46]

[46] Nevertheless, BPA was mindful of the risk that would attend an attempt to go to court to seek refunds from the IOUs. While the REP is essentially an entitlement program, Congress did clothe the program in some of the commercial trappings of a purchase and sale, raising a risk that a court would deny BPA relief on the basis of unclean hands, given that BPA was an architect of the settlement. Consequently, BPA determined that administrative offsets to future REP benefits otherwise owing would be the most prudent course of action and also an equitable one given the entirety of the circumstances. In the context of an entitlement program, where the benefits are the result of the Administrator's ratesetting and ASC determination processes, BPA's administrative offset approach achieves an equitable result.

However, as discussed at length below, the Ninth Circuit is more amenable to estoppel claims against the Government in cases where it is acting in its proprietary capacity.[47] Therefore, even assuming *arguendo* that the Block Contracts were void and each of their provisions, including the waiver provisions, were of no force or effect, the DSIs would likely have a clearer legal path to successfully estop BPA from attempting to recover any overpayments made during the Initial Lookback Period.

C. The record supports a conclusion that there were no overpayments or underpayments.

BPA concluded it must seek repayment from the IOUs, given the *PGE* and *GNA* opinions, for the difference between what was paid to them under the REP Settlement Agreements and what they were entitled to receive if the REP had been implemented pursuant to law and section 7(b)(2) had been properly applied. The WP-07S ROD stated that:

> BPA believes that allowing the IOUs to retain the funds they received under the 2000 REP Settlement Agreements, based solely on the invalidity clause, would undermine the Court's opinions. It would yield an incongruous result of having the Court declare the 2000 REP Settlement Agreements invalid while *permitting the IOUs to use the same invalid agreements to retain funds the Court said they were not entitled to receive.*

WP-07S ROD at 180 (emphasis added). For the reasons discussed above, BPA believes the contractual analysis in the case of the 2007 Block Contracts leads to a different conclusion. In addition, BPA has greater flexibility, even in light of *PNGC I* and *PNGC II*, with respect to the level of power service benefits it may provide to the DSIs compared to the benefits it *must* provide to utilities' residential and small farm consumers under the REP and what costs it *must* not extract from preference customers in that pursuit.

BPA decided in the DSI Service RODs supporting the 2007 Block Contracts that it would provide the DSI smelters with up to $59 million in annual benefits, but it could have physically delivered power at the IP rate to achieve the goal of providing the companies with power costs low enough to make economic operations possible, at a reasonable cost to its other customers.[48]

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[47] *See, e.g.*, United States v. Georgia-Pacific Co., 421 F.2d 92 (9th Cir. 1970) (citing Hatchitt v. United States, 158 F.2d 754 (9th Cir. 1946)); Johnson v. Williford, 682 F.2d 868, 871 (9th Cir. 1982) (generally, equitable estoppel is not available as defense against government, especially when government is acting in its sovereign, as opposed to its proprietary, capacity); *but see* Wagner v. Fed. Emergency Mgmt. Agency, 847 F.2d 515, 519 n.4 (9th Cir. 1988) (holding that party must still show "affirmative misconduct" on part of government in all cases); Rider v. U.S. Postal Serv., 862 F.2d 239 (9th Cir.1988) (same).

[48] The maximum amount of energy BPA can provide a company is based on its 1981 power sales contract "contract demand." Alcoa's contract demand equals approximately 468 aMW, CFAC's contract demand equals approximately 416 aMW, and Port Townsend's equals 20.5 aMW. *See also* 16 U.S.C. §§ 839c(d)(1)(B), (d)(3).

In the case of the Block Contracts, while *PNGC I* held BPA used an invalid rate to calculate benefits paid to the aluminum companies, *PNGC I* did not hold that BPA paid the companies more benefits than it could have provided them if it had based such benefit payments on a valid rate, to the extent such sales were consistent with sound business principles.

The DSI Service RODs make clear that BPA believed the balance between containing costs and providing an appropriate level of service benefit to the DSIs was best achieved by providing up to $59 million per year in benefits. In the 2005 ROD, in describing the rationale for a known, capped amount of benefits to the aluminum companies BPA stated:

> At the outset, it is important to note that BPA is attempting to craft a compromise that will have a known and relatively small impact on the rates paid by its public preference customers, while still making available to the DSIs a level of service benefits large enough to materially improve the likelihood that power costs to the smelters will be low enough to facilitate smelter operations in times when such operations would otherwise be economically infeasible.

2005 ROD at 9. In light of *PNGC II*, however, BPA has interpreted *PNGC I* as requiring that BPA also demonstrate that such sales are consistent with its business interest, which BPA has read to mean that it will, on a forecast basis, accrue net revenues equal to or greater than the forecast costs of each sale. *See* Attachment L at 84-86, *Power Sale to Alcoa Inc. Commencing December 22, 2009 – Administrator's Record of Decision.* BPA and Alcoa filed petitions for rehearing in *PNGC II*.[49] Among other things, BPA requested panel rehearing on the issue of whether *PNGC II*:

> [I]s in conflict with this Court's precedent to the extent it requires BPA to demonstrate compliance with provisions in its statutory framework that reference "sound business principles" by establishing that a non-obligatory, but expressly authorized, contract decision to sell power will result in no "net loss" of revenue to BPA and/or arguably maximize its revenue, akin to what might be expected of a for-profit business.

Respondent Bonneville Power Administration's Petition for Panel Rehearing at 2-3, *PNGC II*, 596 F.3d 1065 (9th Cir. 2010) (Nos. 09-70228, 09-70236, 09-20988).[50] The

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[49] Port Townsend filed an amicus brief in support of panel rehearing regarding "BPA's right and discretion to offer DSI customers (including Port Townsend) a long-term power contract at IP rates." Brief of Amicus Curiae Port Townsend Paper Corporation in Support of Petitions for Rehearing and Suggestion for Rehearing En Banc at 18, *PNGC II*, 596 F.3d 1065 (9th Cir. 2010) (Nos. 09-70228, 09-70236, 09-20988).

[50] For its part, Alcoa argued in its petition for rehearing, among other things, that *PNGC II* is inconsistent with *PNGC I*, which Alcoa reads to require that BPA provide physically delivered power to the DSIs at the IP rate, or monetize the transaction such that net rates paid by the DSI equal the IP rate, and also that *PNGC II* conflicts with other Supreme Court and Ninth Circuit cases interpreting the scope and application

petitions for rehearing were denied, but the court did issue a revised opinion that, among other things, clarified its original opinion with respect to the meaning of sound business principles and addressed the circumstances under which a discretionary power sale may be in BPA's business interest. Noting certain considerations in connection with such a sale that would fall within BPA's expertise, the court concluded, while such considerations did not apply to BPA's Block Contract amendment with Alcoa, that

> [T]he agency's conclusion that a physical sale of power to Alcoa, even at a loss, furthered its business interests might very well warrant our deference.

PNGC II, 596 F.3d 1065, 1085 (9th Cir. 2010). BPA did not expressly address in the DSI Service RODs the issue of whether the 2007 Block Contracts were in BPA's business interest. However, inasmuch as BPA believes that DSI load provides – or has the potential to provide in the future – significant tangible and intangible benefits to the agency, it seems more likely than not that BPA would have elected to provide the companies a level of benefits taking into consideration, and balancing each of the following factors: 1) providing each company with an amount of power for a term sufficient to sustain economic operations; 2) BPA's business interest in maintaining DSI load in an amount and for a term sufficient to provide BPA tangible and intangible benefits; and 3) the net costs (if any) of such service. *See generally* Attachment L at 72-83, *Power Sale to Alcoa Inc. Commencing December 22, 2009 – Administrator's Record of Decision.* It is unlikely BPA would have declined to serve DSI load at a level below the amount adopted in the DSI Service RODs, and BPA could have provided service in a number of different ways, including by allocating additional megawatts to serve the companies' loads (up to their respective contract demands), by extending the term of the contracts, by physically delivering the power and agreeing to absorb additional market price risk, by agreeing to cover the full delta between the Industrial Firm (IP) power rate and the companies' market purchases in the case where benefits were monetized, by providing the DSIs with additional operating flexibilities under the contract, or through some combination of the foregoing.[51]

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of "sound business principles." Intervenor Alcoa Inc.'s Petition for Panel Rehearing and Suggestion for Rehearing En Banc at 9-16, *PNGC II*, 596 F.3d 1065 (9th Cir. 2010) (Nos. 09-70228, 09-70236, 09-20988).

[51] PPC and ICNU argue BPA's conclusion that it would have developed an alternative DSI service construct consistent with the *PNGC* opinions and within the same economic parameters as contained in the Block Contracts is an impermissible *post hoc* rationalization. PPC at 12 (BPA cannot assume it could have done something lawfully and deny preference customers a remedy for an injury caused by what was actually done); ICNU at 4 (BPA cannot create *post facto* rationalizations). Certainly, as a general rule, agency actions are reviewed by examining the administrative record at the time the agency made its decision. Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, at 419-420 (1971); *see also* Bunker Hill Co. v. U.S. Envtl. Prot. Agency, 572 F.2d 1286, 1292 (9th Cir. 1977) (court cannot uphold final actions on the basis of post-hoc rationalizations offered by the agency). However, BPA is not proffering a new rationale to support its conclusion. BPA has continued to develop and offer power sales contracts to the DSIs that are consistent with the court's opinions and that BPA has found consistent with BPA's long-term business interest in maintaining DSI load. *See* Attachments J, K, and L. These facts are explanatory of BPA's view of the merits of service to the DSIs, including for the period covered by the Block Contracts, and are relevant to the issues remanded by the court to BPA. *See* ASARCO Inc., v. U.S. Envtl. Prot. Agency, 616 F.2d 1153, 1160 (9th Cir. 1984) (information outside the administrative record may be considered to use as "background information" and for "ascertaining whether the agency considered all the

Similarly, while BPA believes the record supports a conclusion that BPA would have provided the aluminum companies with $59 million in benefits under the IP rate, and so there were no overpayments that must be refunded to BPA, it also supports the conclusion that BPA would not have made any payments to the companies greater than $59 million, and so there were no underpayments, either.[52] In the 2005 ROD, BPA decided to increase the number of megawatts available to the companies from 500 aMW to 560 aMW, and to increase the annual cap from $40 million to $59 million. BPA decided this increase was warranted to achieve the balance it was seeking between minimally impacting other customers rates and providing a meaningful level of benefits to the companies. *See generally* Attachment A at 9-12, 2005 ROD. However, BPA also decided that, with respect to separate aluminum company proposals to increase the amount of benefits without imposing any cap:

> Proposals that leave the cost of service to the DSIs uncapped violate the principle already adopted by BPA that the cost of DSI service must be known and capped, and will not be adopted.

Id. at 10. BPA concluded that the two caps (560 aMW and $59 million) would work in tandem, and provide the maximum service level benefits that would be provided inasmuch as the capped amounts would "provide a sufficient amount of benefits to help sustain DSI operations under most power market conditions." *Id.* at 11-12.

D. Comments on the REP Lookback

The IOUs disagree with any and all bases upon which BPA attempts to distinguish the DSI Lookback from the REP Lookback. The IOUs assert that there is no basis to assert that the REP Settlement Agreements were void in their entirety any more that there is a basis to conclude that the DSI contracts were void in their entirety. The IOUs state that:

> [T]he Ninth Circuit was careful to recognize BPA's authority to enter REP settlements as a general matter, along with BPA's broad authority under section 2(f) and 9(a) of the Northwest Power Act to exercise discretion on contracting decisions not subject to clear statutory directives.

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relevant factors or fully explicated its course of conduct or grounds of decision."). In any case, even if BPA's evaluation and conclusions on this particular issue can be characterized as new rationalizations, there is nothing inappropriate about that in the context of agency action on remand. In its remand to BPA, the court instructed BPA to evaluate the viability of the Block Contracts, if modified to conform to its opinion. In this context it is reasonable and legally appropriate for BPA to reference these subsequent DSI power sales and the records supporting them as evidence that it would have elected in 2006 to physically serve DSI load at the IP-rate, but within the same economic parameters as the Block Contracts. *See ASARCO*, 616 F.2d 1153, 1159 (if court finds administrative record lacking it should remand matter to agency for further evaluation).

[52] Arguably, "underpayments" would not be possible in the context of a discretionary, physically delivered sale at the IP rate.

IOUs at 7 (citing *PGE*, 501 F.3d 1009, 1030-31). The IOUs conclude that "[n]owhere did *PGE* suggest that the 2000 REP Settlement Agreements were void in their entirety." IOUs at 7.

The IOUs also rely on subsequent case law in support of this point:

> If there were any doubt, the Ninth Circuit made clear several months later that *PGE* had not declared the 2000 REP Settlement Agreements as void in their entirety. In the follow-on Snohomish case, the Court noted that although "BPA may conclude that our decisions [in *PGE*] undermined the basis for the 2000 REP Settlement Agreements," BPA could also "conclude that at least some of the contract provisions continue to be valid and enforceable subject to modifications to make them conform to our prior opinions and the requirements of the [Northwest Power Act]."

IOUs at 7-8 (citing Public Utility Dist. No. 1 of Snohomish County, Washington v. Bonneville Power Administration *(Snohomish)*, 506 F.3d 1145, 1154 (9th Cir. 2007)).

The IOUs, again citing *PGE,* argue the two situations are the same because:

> Just as *PNGC I* affirmed BPA's general authority to enter into monetized power sales contracts with DSIs in appropriate circumstances and with appropriate terms, *PGE* affirmed BPA's general authority to settle REP claims under appropriate terms. *See PGE*, 501 F.3d at 1032 n.20 ("We note that we do not in any way rule on the legality of BPA's settlement authority when it settles out contractual power obligations in a manner consistent with the requirements of the NWPA.").

IOUs at 8.

Finally, the IOUs claim that BPA is wrong to suggest that a damage waiver provision is only enforceable to the extent that other terms of the contract survive, that the ability or inability to modify other provisions of the agreement is "irrelevant to the enforceability of the damages waiver," and that there is no reason that an expressly severable limitation on remedies is enforceable only if other provisions of the agreement can be modified so they are not contrary to law. IOUs at 8. The IOUs also reject BPA's assertion that allowing REP recipients to retain unlawful benefits would thwart the purpose of the court's orders with respect to the REP Settlement. *Id.* at 10.

In its cross-comments, PPC argues that parts of the IOUs' comments are not relevant in this proceeding. According to PPC, the "discussion of whether the IOUs' invalidity clause is enforceable should be beyond the scope of BPA's decisions in the DSI Lookback process." PPCcx at 3. However, PPC also reiterates its position that both the invalidity clause (in the REP Settlement Agreement) and the damages waiver provision (in the DSI Block Contracts) are unenforceable, primarily because "BPA cannot promise to do by contract what it is otherwise not allowed to do by law." *Id.*

E. Evaluation of comments

The issue of whether the invalidity clause in the REP Settlement Agreements is enforceable is the subject of separate litigation. BPA's intent is not to relitigate that issue here, but simply to articulate its rationale for why it believes different outcomes are required in the respective REP Settlement Agreement and DSI Block Contract remands. A core issue the cases share is the enforceability of a damage waiver provision, and BPA anticipates that a court reviewing any challenge to BPA's final decisions in this ROD will be interested in BPA's reasoning for its conclusions in the two cases. With that context in mind, BPA will briefly respond to the IOUs' principal arguments.

As noted numerous times, the *PNGC* court was explicit that it was not invalidating the Block Contracts in their entirety, or declaring that they are void *ab initio*. In contrast, the cases involving the REP Settlement were not explicit in this regard, and BPA has interpreted the court's opinions in the *PGE* to mean that BPA lacked any authority under section 2(f) of the Bonneville Project Act to enter into the REP Settlement Agreements in derogation of its other explicit statutory responsibilities pursuant to section 7(b)(2) and 7(b)(3) of the Northwest Power Act.

The IOUs' citation to the *Snohomish* case does not undermine BPA's conclusion because it recognizes explicitly that "BPA may conclude that our decisions [in PGE] undermined the basis for the 2000 REP Settlement Agreements" just as BPA has done. *Snohomish*, 506 F.3d 1145, 1154 (9th Cir. 2007). Based on its reading of *PGE* and *GNA*, in tandem, BPA could not reach the other possible conclusion that "at least some of the contract provisions continue to be valid and enforceable subject to modifications to make them conform to our prior opinions and the requirements of the [Northwest Power Act]." *Id.*

The IOUs also argue that BPA has asserted that the damage limitations language can only be enforced if other provisions of the contract survive. IOUs at 8. BPA does not disagree with the IOUs' position that a waiver or other damages or remedies-type provision can survive the invalidation of the main agreement *if* the court's ruling would permit the provision to be severed. In fact, as noted earlier, BPA believes the waiver provision in the Block Contracts with the aluminum companies is enforceable whether BPA continued to make sales to the companies or whether the companies continued to operate following a court opinion voiding the contracts in whole or in part. However, BPA in this instance is only attempting to hew to the *PNGC I* remand order which essentially directed BPA to review the severability issue in the context of its desire and ability to make physically delivered sales to the DSIs.

As to BPA's conclusion that retention of the unlawful benefits would thwart the purpose of the *PGE* and *GNA* remand orders, it must be recognized that the *PGE* court invalidated the REP Settlement Agreements and then the *GNA* court further invalidated the rates under which the illegal settlement costs would be recovered, primarily through the rates of the preference customers. It was certainly rational for BPA to conclude that, when the court said, "set rates in accordance with this opinion," that meant that BPA should make every effort to provide appropriate relief to the customers who had been overcharged by inclusion of illegal settlement costs in their rates. *GNA*, 501 F.3d at 1052.

<u>Final Decision</u>

BPA's decision to not seek repayment from the DSIs in response to PNGC I is not inconsistent with BPA's decision to seek recovery from the IOUs in response to PGE because of fundamental differences in the holdings of the court and the type of transactions at issue in the cases. In PGE, the court held that BPA completely lacked statutory authority to enter into the Agreements or to collect the costs of the Agreements in preference customers' rates. This lack of authority was fatal to both the REP Settlement Agreements and to the rates BPA set to recover the costs of the Agreements. Faced with two Ninth Circuit opinions that declared in unequivocal terms that BPA had neither the authority to enter the REP Settlement Agreements nor the right to collect the costs of the Agreements in rates, BPA had little choice but to turn to the question of remedies and develop a process for determining whether, and to what extent, the REP Settlement Agreements had injured BPA's customers.

No such remedial analysis, however, is required in order to respond to the court's decision in PNGC I. The court in PNGC I affirmed BPA's authority to sell to the DSIs, and in doing so, expressly acknowledged that portions of the Block Contracts (such as the waiver provision) may be severable from the unlawful portions of the agreement. In addition, the court did not hold BPA lacked authority to provide the aluminum companies with up to $59 million annually in benefits. Furthermore, even if the court's opinion could be construed as invalidating the agreement, not seeking recovery would be reasonable because of the commercial nature of the DSI transactions. Finally, the administrative record supports the conclusion that it would have been in BPA's business interest to provide a benefit level, in the form of physically delivered power at the IP rate, to the companies equal to or greater than the $59 million it decided on in the DSI Service RODs, and that BPA would have elected to provide the aluminum companies with up to $59 million in service benefits, since that is the level of benefits that, consistent with BPA's long-term business interest in maintaining DSI load, achieved the balance it was seeking between minimally impacting other customers' rates and providing a meaningful level of benefits to the companies.

B. BPA is not contractually prevented from seeking additional payments from Alcoa for the Amendment Lookback Period, but does not have a reasonable legal or equitable basis for doing so. (*PNGC II* remand item)[53]

[53] In general, parties' comments addressed the Initial Lookback Period and the Amendment Lookback Period as a whole, and did not raise issues or make arguments that were applicable only to the Alcoa Amendment. Arguments made regarding BPA's alleged duty to recover, whether BPA can or should pursue restitution, the likelihood that Alcoa may have an estoppel defense, and other general arguments made by customers that are also applicable to the Amendment Lookback Period are addressed generally here and more specifically in the context of the Initial Lookback Period and the Lookback analysis for Port Townsend.

Issue 1: **Whether BPA should seek recovery of money paid to Alcoa under the Amendment, or whether additional money could be owed to Alcoa under the Amendment?**

Short Answer

The Amendment does not contain a damage waiver provision precluding BPA from seeking a refund from Alcoa, but the Amendment was not breached, and it is not clear BPA would have a basis upon which to predicate a claim for traditional contract damages; nor does the *PNGC II* decision in and of itself create a contractual cause of action. BPA does not have a strong equitable basis upon which to seek a refund, because under the circumstances surrounding the Amendment, it is unclear that Alcoa has been unjustly enriched. Finally, because BPA's long-term business interest is served by some level of DSI load operating in the region, it is likely BPA would have found a level of physically delivered IP service to Alcoa after *PNGC I*, commensurate with the economic parameters contained in the Amendment, to be in its business interest, so there arguably were no overpayments that should be recovered now.

Discussion

The following discussion applies only to the Amendment to the 2007 Block Contract by and between BPA and Alcoa, which was successfully challenged in *PNGC II*. No petition for review was filed challenging the amendment with CFAC, which was in all material respects identical to the Alcoa Amendment. BPA did not enter into an amendment with Port Townsend.

Under the Amendment with Alcoa, BPA continued to monetize surplus power sales to the company, but amended the contract to base payments on the IP rate, which BPA believed was the only modification required by *PNGC I* in order to continue the transaction. Upon issuance of *PNGC II*, in which the court expressly held that BPA must also make a determination that any discretionary sale is in its business interest, and that BPA had failed to make that showing, BPA immediately terminated payments to Alcoa under the Amendment, of which two remained to be made. Prior to issuance of *PNGC II* BPA had made eight monthly payments to Alcoa (over the period December 2008 – July 2009) under the Amendment.

In addition to changing the rate under which the sale was made, several other amendments were made, including through section 2(j) of the Amendment, which deleted section 16(c) of the 2007 Block Contract (the damage waiver provision) for the term of the Amendment.[54] BPA believed it was necessary to remove the waiver provision given the fact that it had before it at that time two remands, one in *PNGC I* and the other in

[54] The court in *PNGC II* noted that BPA had yet to address the "validity and applicability" of the damages waiver provision in the 2007 Block Contract, which the court, mistakenly, stated had been incorporated by reference into the Amendment. 596 F.3d at 1086.

GNA, on the issue of the meaning and applicability of these waiver provisions. Since it was not clear at that time how those issues would be disposed of on remand, because parties had argued these waiver provisions were unlawful, it was prudent to simply remove the provision via the Amendment. BPA did not, however, substitute for the waiver a provision requiring repayment by Alcoa in the event the Amendment was held unlawful by the court, nor was it BPA's intent by removing the waiver provision to seek repayment in such event. In fact, the same policy rationale for not seeking a refund, as outlined herein and in the DSI Service RODs, also applies to the Amendment Lookback Period.

As explained above with respect to the Initial Lookback Period, BPA does not believe it is obligated by law to seek a refund, even if it is not otherwise contractually prohibited or equitably estopped from doing so. The same analysis and conclusion apply to the Amendment. Payments to Alcoa under the Amendment, although inconsistent with the Northwest Power Act to the extent that BPA failed to first make a determination that the Amendment was in BPA's business interest, were nevertheless not in violation of the Appropriations Clause. Nor did the court in *PNGC II* hold that the Amendment was void *ab initio*, but rather that it was invalid to the extent BPA had failed to demonstrate that entering into the Amendment was consistent with sound business principles. *PNGC II* at 1085.

As noted earlier, the court has acknowledged that there may be circumstances where it would defer to a BPA decision to enter into a physical power sale at a loss, if such sale otherwise furthered BPA's business interest, presumably including in this case. As discussed under Issue 2, section IV.C, in contrast to the REP Settlement – which was found by the court to be beyond BPA's authority and therefore unenforceable – it is likely BPA could have provided substantial, and legally sustainable, support for a physical sale to Alcoa at the IP rate for the period covered by the Amendment, based on its business interest in preserving DSI load.[55] If BPA were to make such a determination – and the court were to defer to the agency in that determination – that would seem to foreclose the need for any refund. BPA believes the record would support a finding that, in lieu of a monetized deal, it would have been in BPA's business interest to serve Alcoa under the same economic parameters contained in the Amendment, but in a physically delivered transaction at the IP rate.

However, assuming *arguendo* BPA determined service to Alcoa during the period of the Amendment would *not* have furthered its business interest, the question becomes whether there is a legal or equitable basis on which BPA could seek a refund.[56] Notwithstanding the fact the Amendment contains no waiver, by either party, of any right to seek a refund

[55] *See generally* Attachment L at 72-83, *Power Sale to Alcoa Inc. Commencing December 22, 2009 – Administrator's Record of Decision.* The terms of a physically delivered sale would have been structured so as to take into consideration BPA's cost cap goals as outlined in the DSI Service RODs, and the fact that Alcoa would need to remarket some or all the market power it had previously purchased to serve its load.

[56] Or as expressed by the court in remanding to BPA, "whether and how it will seek a refund from Alcoa." *PNGC II* at 846.

or damages as a result of the court's decision in *PNGC II*, BPA lacks a clear contractual basis to seek a refund from Alcoa under the Amendment. Alcoa did not breach any obligation to BPA under the Amendment, so it is not clear a legal claim for money, in the form of damages or otherwise, could be pursued by BPA under the Amendment based solely on *PNGC II*, which does not in and of itself create a cause of action.[57]

Without a clear legal remedy at its disposal, BPA would be left with only the possibility of pursuing an extra-contractual or equitable claim for restitution based on an unjust enrichment theory. However, unlike the investor-owned utilities with respect to the REP Settlement Agreements, Alcoa may have a meritorious argument that, in the event BPA pursued an extra-contractual claim for restitution, that in the context of a commercial transaction such as the Block Contract, and the Amendment thereto, BPA should be estopped from seeking restitution from Alcoa. The basis for this observation is outlined in the estoppel analysis discussed below, where the elements of such a claim are outlined in the context of the Port Townsend Lookback.

Even if an estoppel defense were unavailable to Alcoa in this case, however, it is far from clear that BPA would be able to pursue a claim against Alcoa for unjust enrichment in the first instance. Without attempting to weigh the merits of Alcoa's contention that it was not unjustly enriched, BPA believes it could not successfully convince the Department of Justice to initiate litigation based on nothing more than a bare equitable claim of unjust enrichment without some tangible and prospective governmental interest at stake (such as the implementation of a broad based government benefits program), or some egregious conduct on the part of Alcoa. In general, unjust enrichment claims are used primarily to bolster other claims or to support government policy interests. For example, the Government may intervene in a *qui tam* proceeding, and claim unjust enrichment as part of its claim, in the interest of combating fraud pursuant to the False Claims Act. *See, e.g.*, United States ex rel. Ritchie v. Lockheed Martin Corp., 558 F.3d 1161 (10th Cir. 2009) at 1168-1169 (federal interest in protecting the Federal Government's right to recover under the False Claims Act).

Further, the approach taken in *Ritchie* seems consistent with the requirement of at least some of the courts that there be some element of fraud, duress, or the taking of an undue advantage necessary to find unjust enrichment. *U.S. v. Medica Rents Co.*, Nos. 03-11297, 06-10393, 07-10414, 2008 WL 3876307, at *3-4 (5th Cir. Aug. 19, 2008). Were this standard to be applied to the DSI transactions, it would be difficult to prove the existence of fraud, duress, or taking of undue advantage required in *Medica Rents*.

Thus, BPA's investigation suggests that in order to persuade the Department of Justice to pursue an unjust enrichment claim against Alcoa (and, for that matter, Port Townsend) BPA would have to make one of two showings: 1) the suit is necessary to support some tangible government policy like prevention of fraud pursuant to the False Claims Act; or 2) the existence of conduct on the part of the recipient of the benefit that amounted to fraud, duress, or taking of undue advantage. The facts in this case do not support a

[57] Preference customers' argument that BPA's alleged legal duty to seek recovery itself creates a legal cause of action is addressed in the discussion of the Initial Lookback Period.

recommendation by BPA that the Department of Justice pursue a stand-alone claim for unjust enrichment against Alcoa.

Final Decision

While the Amendment does not contain a damage waiver provision precluding BPA from seeking a refund from Alcoa, PNGC II does not require that BPA seek a refund, nor is BPA otherwise legally bound to seek a refund. Since the underlying contract was not breached, it is not clear BPA would have a basis upon which to predicate a claim for traditional contract damages, and the PNGC II decision in and of itself does not create a contractual cause of action. Neither would there be a strong equitable basis upon which BPA could seek a refund, inasmuch as under the circumstances surrounding the Amendment, it is unclear that Alcoa has been unjustly enriched in a manner that would support a recommendation that the Department of Justice pursue this through litigation. Finally, because BPA believes its long-term business interest is served by some level of DSI load operating in the region, it is likely BPA would have found a level of physically delivered IP service to Alcoa after PNGC I, commensurate with the economic parameters contained in the Amendment, to be in its business interest.

V. PORT TOWNSEND/CLALLAM TRANSACTION

With respect to the transaction BPA entered into with Clallam for providing power to Port Townsend, BPA posited in its June 10 letter that the fundamental threshold issue is whether:

> BPA is permitted to seek additional payments directly from Port Townsend Paper Company (or indirectly through the Public Utility District No. 1 of Clallam County) for any undercharges for power delivered to Clallam by BPA for the benefit of Port Townsend, both during the Lookback Period and subsequently.

The analysis concerning the Port Townsend transaction differs from the aluminum company transactions because the contract structure and language differ significantly. The Port Townsend transaction is comprised of two contracts: one between BPA and Clallam, whereby BPA agreed to sell to Clallam surplus firm power, at a rate equal to the Priority Firm (PF) power rate, plus the industrial margin included in BPA's IP rate, for resale by Clallam to Port Townsend.[58] *See* Attachment E. The second contract is between Clallam and Port Townsend, and provides for the resale by Clallam to Port Townsend of the surplus firm power purchased by Clallam from BPA, at a rate equal to all costs paid by Clallam to BPA under the Clallam/BPA Contract, plus certain other charges. *See* Attachment F. Unlike the Block Contracts, there is no waiver provision directly and expressly applicable to BPA that would prohibit BPA from seeking refunds against Port

[58] As noted earlier, each contract has been terminated, but liabilities and obligations are preserved until satisfied.

Townsend, although it seems any contract claim for recovery would have to be made through Clallam, since BPA and Port Townsend are not contractual counter-parties.

In addition, unlike the aluminum company transactions, it does not appear that BPA could have structured the transaction for Port Townsend using the IP rate in a way that would have resulted in a benefit level equal to or greater than the benefits Port Townsend was provided under the invalidated transaction (and so conclude there were no overpayments).[59] Equally true, however, is the fact that the contract provided for physically delivered power at a price established pursuant to a contract. The power was purchased at that price and so it cannot be said the BPA did not receive its bargained-for consideration under the contract.

Issue 1: **<u>Assuming a refund amount would otherwise be found to be owed by Port Townsend, does the BPA/Clallam Contract provide a mechanism for BPA to seek and recover such a refund?</u>**

Short Answer

While neither the BPA/Clallam nor the Clallam/Port Townsend contract expressly prohibits back-billing, both Clallam and Port Townsend could raise *bona fide* contractual arguments against such back-billing. In addition, while BPA did not provide a waiver and is not expressly prohibited from seeking a refund against Port Townsend through the BPA/Clallam Contract, BPA would have provided such a waiver, consistent with its waiver in the Block Contracts, if it had known Port Townsend would be required to provide a waiver in the Clallam/Port Townsend Contract. Because Port Townsend, in fact, waived any right it may have had to damages in the event the Port Townsend transaction was rendered void or otherwise unenforceable by court action, it would be inconsistent with the considerations behind the mutual waivers for BPA to seek a refund when Port Townsend will already be required to pay BPA more for power in FY 2010 and 2011 than it would have under the original transaction.

Discussion

A. *PNGC I* held BPA provided an illegally high subsidy to Port Townsend through Clallam.

[59]This is because BPA provided power to Clallam under the BPA/Clallam Contract at an effective rate below the IP rate. BPA committed to provide Port Townsend (through Clallam) up to 17 aMW. However, in the event BPA had known it was limited to offering Port Townsend power at what it believed, relative to the alternative, would be a higher IP rate, BPA may have elected to provide Port Townsend up to 20.5 aMW, which is Port Townsend's maximum BPA contract demand as established through its 1981 power sales contract. Assuming that these additional 3.5 aMW of IP power would have displaced a more expensive power supply actually used by Port Townsend, then it may be argued that this incremental economic benefit should be taken into account when calculating any refund assessed against Port Townsend. This would require a determination that such a sale was consistent with sound business principles.

The court in *PNGC I* only minimally addressed the surplus sale by BPA to Clallam and the corresponding resale by Clallam to Port Townsend. While the court clearly understood there were two contracts comprising the overall transaction, the court's analysis conflates the contracts, noting that the effect of the contracts taken together is to "commit BPA to sell power to Port Townsend (through Clallam) at a rate below both the market rate and the IP Rate." *PNGC I*, 580 F.3d at 821 n.34; *see also PNGC I* at 824 n.40 ("[t]hrough the combined contracts, therefore, BPA has agreed to supply Port Townsend with 17 aMW of power at a rate approximately equal to $29/MWh.").[60] The court's analysis and conclusion accurately captures the purpose and intent of the transaction, since while the contracts are distinct, and neither expressly incorporates the other, it is clear from provisions in each contract (and from the DSI Service RODs) that they were interdependent and neither could stand alone absent the continued operation of the other. *See* Attachment E, BPA/Clallam Contract, second recital, section 5, section 13(f); Attachment F, Clallam/Port Townsend Contract, fourth recital, section 4, section 14.[61]

Nevertheless, a threshold question is whether Port Townsend is subject to refund liability pursuant to any holding in *PNGC I* since it is not a party to a contract with BPA, and since the court did not invalidate (and may well not have had jurisdiction over) Port Townsend's contract with Clallam. The central holding in *PNGC I* with respect to Port Townsend was that the "Clallam/Port Townsend contract is also invalid." *PNGC I*, 580 F.3d at 825. Again, the court appears to be referring to the combined, BPA/Clallam - Clallam/Port Townsend transaction through which Port Townsend received, indirectly through Clallam, below-IP rate BPA power. In addition, the court holds that "[e]ven if we considered only the BPA/Clallam contract, our conclusion that the contract rates are invalid would not change." *Id.* at 825 n.41.[62] In other words, while the court's jurisdiction arguably extended only to the BPA/Clallam Contract, in concluding that the effect of the overall transaction was that BPA (not Clallam) was providing Port Townsend power at an improper rate, albeit indirectly, the court essentially invalidated the totality of the transaction.

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[60] Although the court understood there were two distinct two-party contracts, nevertheless it somewhat confusingly makes repeated reference to the "BPA contract with Clallam/Port Townsend" as if BPA had a direct contractual relationship with Port Townsend (*e.g.*, "BPA's contract with Clallam/Port Townsend suffers from the same central deficiency as BPA's contracts with the aluminum DSIs." *PNGC I* at 825; *see also PNGC I* at 825 n.42: "BPA's contract with Clallam/Port Townsend may also run afoul of BPA's statutory requirement to first offer power to a DSI at the IP rate before selling it to the DSI under the FPS rate schedule.") It seems that the court's use of the term "Clallam/Port Townsend contract" is short-hand for the overall transaction, looking at the contracts as a piece. Also, in footnote 41 of the opinion, the court makes clear that its holding is based on an analysis of the overall transaction, not just the BPA/Clallam contract ("[e]ven if we considered only the BPA/Clallam contract . . ."). *Id.* at 825.

[61] *See also* Attachment F, BPA/Clallam Contract, section 14(d) (which was intended to allow BPA to terminate the BPA/Clallam Contract in the event Port Townsend failed to make a payment when due under any other BPA/Port Townsend Contract, *e.g.*, a transmission contract).

[62] While it is not clear which "contract rates" the court is referring to, in the context of the footnote it appears to be referring to the rate charged by BPA to Clallam. In other words, the court appears to hold that even if BPA had entered into the BPA/Clallam sale for the sole benefit of Clallam (and not Port Townsend), the contract would still be invalid as inconsistent with "sound business practices."

B. While neither the BPA/Clallam or the Clallam/Port Townsend contract expressly prohibits BPA from seeking a refund against Port Townsend through the BPA/Clallam Contract, such a course is problematic.

Notwithstanding that the court conflated the two contracts in reaching its conclusion that Port Townsend received benefits from the use of the wrong rate by BPA, BPA does not have a direct contractual relationship with Port Townsend. Port Townsend's intended third-party beneficiary status under the BPA/Clallam Contract only gives Port Townsend certain rights to enforce the respective obligations of BPA and Clallam under the BPA/Clallam Contract. By contrast, the Clallam/Port Townsend Contract provides that the parties intended there be no "direct or indirect" third-party beneficiaries to that contract. *See* Attachment F, section 13(f). Thus, there is no basis for BPA to argue that it is a third-party beneficiary to the Clallam/Port Townsend Contract, or how that status (if it could be established) would provide BPA with the right to pursue a contract action directly against Port Townsend for a refund.

If a refund against Port Townsend is contractually permitted (i.e., it is not prohibited by either the BPA/Clallam or Clallam/Port Townsend Contracts), then it appears the refund would have to be sought through the BPA/Clallam Contract. There does not appear to be any language in either the BPA/Clallam Contract or in *PNGC I* that would prohibit BPA seeking a refund against Port Townsend through the BPA/Clallam Contract.

However, while there is no provision in the BPA/Clallam Contract that expressly prohibits BPA from issuing something akin to a revised final bill to Clallam reflecting additional amounts owed by Clallam to BPA based on the holding in *PNGC I*, neither does the contract provide for such a result.[63] For its part, section 4(a) of the Clallam/Port Townsend Contract contemplates that Clallam will bill Port Townsend for "any and all charges" billed to Clallam by BPA "including without limitation all costs, charges, surcharges, adjustment charges and penalties." Section 4(b) of that contract provides that Clallam may unilaterally revise the rates it charges Port Townsend "as necessary to reflect any changes in the charges to Clallam" by BPA. However, it is far from clear to BPA that if BPA back-billed Clallam, that Port Townsend would voluntarily remit such amount to Clallam when it, in due course, received its bill from Clallam reflecting such back-billing.[64]

[63] With respect to the argument in the REP lookback that BPA may not engage in retroactive ratemaking, BPA concluded in the WP-07S ROD that "there is no prohibition on retroactive adjustments applicable to BPA, and if there were, the Lookbacks would constitute an appropriate exception to such standards" and that "the filed rate doctrine is not applicable in this instance." WP-07S ROD, Ch. 2, p.23. Here, unlike in the REP lookback, no new rates need to be developed, BPA would apply the posted IP rates for the period applicable to the Lookback. Nor would the prohibition on retroactive rulemaking apply since BPA would not be modifying the rate itself.

[64] Port Townsend argued at some length in its initial comments that any claim BPA may have against it has likely been discharged pursuant to the Confirmation Order of the U.S. Bankruptcy Court for the Western District of Washington, approving the final plan for Port Townsend's bankruptcy reorganization. Port Townsend at 3-6. Port Townsend filed its bankruptcy petition on January 29, 2007, approximately four months after the BPA-Clallam-Port Townsend transaction was signed, and approximately 24 months prior to the issuance of *PNGC I*. Port Townsend, citing *In re MCI, Inc.*, No. 02-13533, 2006 WL 544494

Of course, there are obvious limitations to operating on the assumption that, because a thing is not expressly prohibited in a contract, it is therefore permitted. A singular purpose of express contracts is to avoid such ambiguities. Obviously, since there is no express authorization in the Clallam/BPA Contract for BPA to unilaterally and retroactively change the negotiated rate, Clallam would have compelling contractual arguments that such an attempt to adjust the rate is a material breach of the contract. This is particularly true in light of the fact that the BPA/Clallam Contract contains an integration clause, which requires any modifications to be embodied in writing and signed by both parties.

Moreover, while the principal holding in *PNGC I* is that BPA provided power to Port Townsend at an improper rate, due to the interdependent nature of the contracts, this also means that the BPA/Clallam Contract rate provisions are invalid. The court notes it would have invalidated the BPA/Clallam Contract even absent Port Townsend's involvement. However, BPA does not interpret this to mean that BPA would have an independent refund claim against Clallam. Clallam received no tangible benefit from BPA under the BPA/Clallam Contract, and if it did receive any intangible or other benefit under the Clallam/Port Townsend Contract, that is not relevant to the issues presented in this remand. Therefore, there are no circumstances under which BPA would attempt to back-bill Clallam under the BPA/Clallam Contract for any refund amounts found to be due and owing by Port Townsend absent assurance that Clallam could obtain reimbursement without resorting to litigation or otherwise incurring financial exposure.

C. The logic for the damage waiver in the Block Contracts also applies to the Port Townsend transaction.

As the court noted, unlike the aluminum smelter contracts, the damage waiver provision in the BPA/Clallam Contract (section 14(b)) bars only Clallam, not BPA, from recovering damages in the event the court issues a decision that renders the contract void or otherwise unenforceable. *PNGC I*, 580 F.3d at 826 n.44. The DSI Service RODs do not address the waiver issue in the context of the Port Townsend transaction, because no party that commented on the draft Port Townsend contracts raised any issue with respect to the existence or non-existence of a waiver. However, the waiver in the aluminum company contracts implements the parties' intent to allocate equally the financial risk associated with the court invalidating the contract – the aluminum companies would not be required to refund any payments, and BPA would not be liable to the companies for any damages or other payments in the event the Block Contracts were "void" or

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(Bankr. S.D.N.Y. Jan. 27, 2006), argues the circumstances giving rise to any BPA claim arose pre-petition, and that BPA was therefore required to file a proof-of-claim for any Lookback claim in the bankruptcy proceedings. However, the Ninth Circuit has held that a claim arises under the bankruptcy code once it is within the claimant's "fair contemplation." *See, e.g.,* In re Zilog, Inc., 450 F.3d 996 (9th Cir. 2006). Without concluding one way or the other, it does seem an argument could be made that it could not have been within BPA's "fair contemplation" that it may have either a contractual or equitable claim against Port Townsend until *PNGC I* was issued in December 2008, approximately 15 months after Port Townsend's bankruptcy plan was confirmed and effective.

"otherwise enforceable" as written. This rationale appears to apply equally to the Port Townsend transaction in the circumstances. The Clallam/Port Townsend Contract does contain a waiver by Port Townsend of any damage claims against Clallam in the event the BPA/Clallam Contract is terminated. *See* Attachment F, section 14. If Clallam could not be sued by Port Townsend it is unlikely BPA would face any derivative liability through Clallam, and it is unlikely Port Townsend's third-party beneficiary status under the BPA/Clallam Contract would give it any argument that BPA must pay for any damages it may have incurred due to *PNGC I*. This conclusion, again, is based primarily on the interdependence of the two contracts. BPA is protected by a limitation on damages in the BPA/Clallam Contract. Clallam, in turn, is protected from damages in the Clallam/Port Townsend Contract.

BPA did not offer a waiver to Clallam in the BPA/Clallam Contract because BPA routinely makes surplus sales to its preference customers and believed it had significant pricing latitude for such sales. Also, BPA did not know whether Port Townsend would, in fact, be required by Clallam to waive damage claims on its end of the transaction. Inasmuch as it did so, it would seem the same considerations that led to the mutual waiver in the Block Contracts exist with respect to the Port Townsend transaction and should produce the same result.

Final Decision

PNGC I held that pursuant to the BPA-Clallam-Port Townsend transaction BPA undercharged Clallam for power sold by BPA to Clallam for Port Townsend's benefit. While the BPA/Clallam Contract does not prohibit BPA from back-billing Clallam for such power, it does not provide for revision of the rate and back-billing. Even if BPA billed Clallam, it is not clear that Port Townsend would pay Clallam such amounts in due course, and each of them could likely raise bona fide contractual arguments against such back-billing. While BPA did not provide a waiver to Clallam, BPA would have provided such a waiver, consistent with its waiver in the Block Contracts with the aluminum companies, if it had known Port Townsend would be required to provide a waiver in the Clallam/Port Townsend Contract. Because Port Townsend, in fact, waived any right it may have had to damages in the event the Port Townsend transaction was rendered void or otherwise unenforceable by court action, it would be inconsistent with the considerations behind the mutual waivers for BPA to seek a refund when Port Townsend will already be required to pay BPA more for power in FY 2010 and 2011 than it would have under the original transaction.

Issue 2: **Assuming the BPA/Clallam Contract is not or cannot be used to seek refund from Port Townsend, could BPA successfully pursue a refund directly against Port Townsend?**

Short Answer

BPA does not believe that it could successfully pursue a refund directly against Port Townsend, because 1) the elements necessary to make an unjust enrichment claim against

Port Townsend have not been met in this case, and 2) in the event that BPA did have a viable unjust enrichment claim, Port Townsend could potentially assert an equitable estoppel defense against BPA. Because of the low chance that BPA would actually recover, BPA does not believe that pursuit of recovery directly against Port Townsend is a prudent course of action.

Discussion

While the BPA/Clallam Contract is not – either as a practical or legal matter –available as a vehicle to pursue a refund against Port Townsend, BPA has also investigated whether it may have recourse to seek a refund by other means, specifically whether it may have a viable claim for restitution.

A. BPA does not have an unjust enrichment claim against Port Townsend.

"Restitution" means the restoration or giving back of something to its rightful owner, and is an equitable remedy since it is not based upon a contract action. A finding of unjust enrichment is a prerequisite to restitution. When restitution is the primary basis of a claim, as opposed to a breach of contract or other action for contract damages, it invokes the concept of a contract implied at law, because no express or implied in fact contract exists that covers the subject matter. *See, e.g.*, Nematollahi v. United States, 38 Fed. Cl. 224 (1997); U.S. Quest Ltd. v. Kimmons, 228 F.3d 399 (5th Cir. 2000); SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 68:1 (4th ed. 1993) (quasi-contractual liability is imposed independent of any express contract, provided the subject matter of the dispute is not covered by an express contract).[65] While the BPA/Clallam and Clallam/Port Townsend Contracts together arguably constitute a contractual arrangement that addresses the subject matter of any refund claim, thereby precluding any equitable claim by BPA, the rule that a remedy in equity is not available where an adequate remedy exists at law is limited to cases in which there is an adequate legal remedy against the party allegedly unjustly enriched. *See* Mort v. United States, 86 F.3d 890, 892 (9th Cir. 1996) (equitable relief should not be denied unless the available legal remedy is against the same person from whom equitable relief is sought). Since BPA's legal (or contractual) remedy (if any) would be through the BPA/Clallam Contract, it does not appear BPA would be precluded from seeking an equitable remedy directly against Port Townsend.

Nonetheless, there remains a substantial risk that a court would deny a request for restitution because an express contract exists that covers the subject matter for which restitution is being sought. Additionally, Port Townsend could reasonably claim that it was not unjustly enriched in that the contractual arrangement, on its face, objectively shows that Port Townsend was a *bona fide* purchaser for value. *See* International Air

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[65]The obligation in a contract implied at law arises not from the consent of the parties as in the case of an express or implied in fact contract, but from the law of justice and equity. G.S. Rasmussen & Assocs. v. Kalitta Flying Servs., Inc., 958 F.2d 896 (9th Cir. 1992).

Response v. United States, 75 Fed. Cl. 604 (2007) (holding that because plaintiff established that it was a *bona fide* purchaser for value, defendant United States could not demonstrate that the plaintiff was unjustly enriched). The parties negotiated a price for physically delivered power, BPA delivered the power, and in consideration of such delivery, Port Townsend (through Clallam) paid the negotiated price. While BPA is not concluding that a *bona fide* purchaser defense is dispositive in this case, if BPA were to pursue this course, it does represent a significant risk factor to prevailing in any litigation.

At a minimum, BPA would have to prove the existence of a contract implied at law (or quasi-contract). Such a contract may exist where the following elements are met: 1) a benefit is conferred upon the defendant by plaintiff, 2) there is appreciation or realization of the benefit by the defendant, and 3) there is acceptance or retention by defendant of the benefit under such circumstances that it would be inequitable to retain it. *Int'l Air Response*, 75 Fed. Cl. at 612. These are the elements needed to show unjust enrichment, which is a prerequisite to a successful claim for restitution.[66] It appears that BPA could potentially meet the first two elements (although as discussed below, Port Townsend argues it was worse off as a result of the transaction compared to the likely alternatives), with the more difficult question being whether the third element would be met, *i.e.*, whether under the circumstances it would inequitable for Port Townsend to retain benefits it received in excess of the level BPA was authorized to provide.

As discussed more fully below, it is not clear to BPA that merely because *PNGC I* held that Port Townsend received BPA-supplied benefits in excess of those permitted under law, that under the circumstances it would be inequitable for Port Townsend to retain those benefits. As noted above, Port Townsend can argue with some force that it is a *bona fide* purchaser for value and was not unjustly enriched. In fact, as described below, Port Townsend argues it was not unjustly enriched by the transaction because, in fact, its power costs increased, not decreased, due to BPA's decision to offer the BPA-Clallam Contract rather than providing 20.5 aMW of DSI service to Port Townsend at the IP rate. However, in the unlikely event that it could be established that each of the unjust enrichment elements are met, the next question would be whether Port Townsend could successfully interpose an estoppel defense to recovery by BPA.

B. Even if BPA could establish an unjust enrichment claim, Port Townsend would likely assert an equitable estoppel defense against BPA.

1. Estoppel against the Government generally

Estoppel is essentially a generic term describing the broad category of defenses that a party may have against another party's claim against it for equitable relief. While it is true that it is difficult to successfully assert an estoppel defense against the United States, it is not true as a matter of law that equitable estoppel is never available to a litigant to

[66] *See also* Or. Laborers-Employers Health & Welfare Trust Fund v. Phillip Morris, Inc., 185 F.3d 957 (9th Cir. 1999) (applying Oregon law); Nematollahi v. United States, 38 Fed. Cl. 224 (1997) (applying federal law).

use against the Government. The Supreme Court laid down the general principle governing claims of estoppel on behalf of private individuals against the Government in *Utah Power & Light Co. v. United States*, 243 U.S. 389 (1917), where it held that "[a]s a general rule, laches or neglect of duty on the part of officers of the Government is no defense to a suit by it to enforce a public right or protect a public interest." *Id.* at 409.[67] This rule has been applied in numerous cases, and while it does not appear the Supreme Court has ever held the United States to be estopped by the representations or conduct of its agents, see *Office of Personnel Management v. Richmond*, 496 U.S. 414, 433 (1990); *Heckler v. Community Health Services of Crawford County*, 467 U.S. 51, 67 (1984), it has held that it is still an open question whether "affirmative misconduct" on the part of the government might be grounds for estoppel. *See* Schweiker v. Hansen, 450 U.S. 785, 788-89 (1981); Immigration & Naturalization Serv. v. Hibi, 414 U.S. 5, 8-9 (1973); Montana v. Kennedy, 366 U.S. 308, 314-15 (1961). The Ninth Circuit has adopted the "affirmative misconduct" standard and it is probably fair to conclude based on the case law that the Ninth Circuit is more receptive to claims of estoppel against the Government than some other circuits, and that its analysis is more infused with the concepts of fairness and equity as guiding principles. *See* Lavin v. Marsh, 644 F.2d 1378 (9th Cir. 1981).

2. Ninth Circuit case law regarding estoppel against the Government

The Ninth Circuit has declined to "set forth an all-purpose test to detect the presence of affirmative misconduct" but rather the court will "review the facts and ask whether under all the circumstances affirmative misconduct has occurred." Lavin v. Marsh, 644 F.2d 1378, 1382 (9th Cir. 1981).[68] The use of the word "misconduct" in the term "affirmative

[67] The logic behind the rule is described by the Supreme Court in this way: "[w]hen the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined. It is for this reason that it is well settled that the Government may not be estopped on the same terms as any other litigant." Heckler v. Cmty. Health Servs. of Crawford County, 467 U.S. 51, 60 (1984). The rule seems rooted in fiscal, separation of powers, and sovereign immunity principles. *See, e.g.*, Wilber Nat'l Bank of Oneonta, N.Y. v. United States, 294 U.S. 120, 123-124 (1935) ("The United States are neither bound nor estopped by the acts of their officers and agents in entering into an agreement or arrangement to do . . . what the law does not sanction or permit"); Schuster v. Comm'r, 312 F.2d 311, 317 (9th Cir. 1962) ("[T]he tendency against Government estoppel is particularly strong where the official's conduct involves questions of essentially legislative significance, as where he conveys a false impression of the laws of the country. Obviously, Congress's legislative authority should not be readily subordinated to the actions of a wayward or unknowledgeable administrative official"); Portmann v. United States, 674 F.2d 1155, 1159 (7th Cir. 1982) (estoppel against government would permit government employees to legislate by misinterpreting or ignoring an applicable statute or regulation); Office of Pers. Mgmt. v. Richmond, 496 U.S. 414, 433 (1990) (estoppel claims would permit endless litigation over both real and imagined claims by citizens of government misinformation, creating an unpredictable drain on public fisc).

[68] The Ninth Circuit has found affirmative misconduct (or its functional equivalent prior to the time the "affirmative misconduct" label was used) supporting a valid estoppel defense in cases where the Government was acting in its sovereign capacity. *See, e.g.*, United States v. Lazy FC Ranch, 481 F.2d 985 (9th Cir. 1973); United States v. Wharton, 514 F.2d 406 (9th Cir. 1975); Sun Il Yoo v. Immigration & Naturalization Serv., 534 F.2d 1325 (9th Cir. 1976). These earlier cases held that estoppel would be available where the Government's "wrongful conduct threatens to work a serious injustice and if the public's interest would not be unduly damaged by the imposition of estoppel, even if the [G]overnment is

misconduct" is somewhat confusing, because while the standard does require a showing of an "affirmative misrepresentation or affirmative concealment of a material fact by the government," it does not require that "the government intend to mislead a party." Watkins v. United States, 875 F.2d 699, 707 (9th Cir. 1989); *see also* Jablon v. United States, 657 F.2d 1064, 1067 (9th Cir. 1981) (noting that Ninth Circuit case law does not require that the Government intend to mislead a party, and that affirmative misconduct for equitable estoppel purposes can be present when the Government acted by providing incorrect information); Office of Pers. Mmgt. v. Richmond, 496 U.S. 414, 430 (1990) (finding that a claim based on repeated provision by government of incorrect information is "in practical effect one for misrepresentation"). In addition, since estoppel is available against the Government only if the agent acted within the scope of his authority, then the Supreme Court cannot have intended that "affirmative misconduct" require an intentional misrepresentation or concealment before his conduct could estop the Government. Such a requirement would be irreconcilable with the Court's long-standing rule that the Government cannot be estopped by the unauthorized conduct of its agents. *See* Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947). It is hard to imagine a situation where the conduct of an agent can be both intentionally tortious *and* authorized by statute.

The standard, however, appears to require more than the Government, through its agents, formally or informally, carelessly or negligently providing incorrect information; rather it seems to require conscious and deliberate conduct, or "ongoing active misrepresentations" by government officials "acting well within their scope of authority." *Watkins*, 875 F.2d at 708; *see also* Moser v. United States, 341 U.S. 41, 47 (1951) (United States estopped where it had created "misleading circumstances" by its affirmative actions); Immigration & Naturalization Serv. v. Hibi, 414 U.S. 5, 8-9 (1973) (estoppel not available where United States merely failed to advise party of statutory time limitation); Pauly v. United States, 348 F.3d 1143, 1150 (9th Cir. 2001) (affirmative misconduct going beyond mere negligence required); Mukherjee v. Immigration & Naturalization Serv., 272 F.2d 1006 (9th Cir. 1986) (estoppel denied in absence of "deliberate lie" or "pattern of false promises"). While not every form of official misrepresentation will be considered sufficient to estop the Government, "some forms of erroneous advice are so closely connected to the basic fairness of the administrative decision making process that the Government may be estopped from disavowing the misstatement." Brandt v. Hickel, 427 F.2d 53, 56 (9th Cir. 1970).[69]

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acting in a capacity that has traditionally been described as sovereign (as distinguished from proprietary) although we may be more reluctant to estop the [G]overnment when it is acting in this capacity." *Lazy FC Ranch* at 989. The facts in *Lazy FC Ranch* seem to support, at best, a case of negligent and erroneous advice by the government official which the other party relied on to its detriment, but the court dealt with this by noting that "[w]e think it important to note that the more responsible the individual giving the advice, the more reasonable the reliance and the greater the injustice in not permitting the application of the estoppel defense." *Id.* at 990 n.6.

[69] *See also* United States v. Locke, 471 U.S. 84, 111 (1984) (O'Connor, J., concurring) (noting that, on remand back to the lower court, a possible finding that the government was estopped from extinguishing a mining claim given its *well intentioned but erroneous* written and oral instruction to claim holder regarding deadline for filing claim renewal would not necessarily be precluded by Court's previous cases addressing estoppel).

3. Proprietary versus sovereign activities

The general rule against estoppel and the "affirmative misconduct" standard were developed in the context of the Government acting in its sovereign, or regulatory, capacity. Despite the reluctance of the Supreme Court to estop the United States when it has performed a sovereign function, some circuit courts held that the Government may be estopped "when it serves an essentially proprietary role and its agents act within the scope of their delegated authority." Fed. Deposit Ins. Corp. v. Harrison, 735 F. 2d 408, 411 (11th Cir. 1984) ("[a]ctivities undertaken by the government primarily for the commercial benefit of the government or an individual agency are subject to estoppel while actions involving the exercise of exclusively governmental or sovereign powers are not").[70]

Early Ninth Circuit cases exploring the boundaries of estoppel against the Government hewed closely to this distinction between the proprietary and sovereign functions. In *United States v. Georgia-Pacific Co.*, 421 F.2d 92 (9th Cir. 1970), the Ninth Circuit found that estoppel may be available against the United States where the Government was acting in its proprietary rather than sovereign capacity, its representative had acted within the scope of his authority, and the elements of equitable estoppel that would apply between private litigants have otherwise been met. At this time, however, there was no mention of the affirmative misconduct test, which appears to have been introduced later by the Supreme Court in *Immigration & Naturalization Service v. Hibi*, 414 U.S. 5, 8 (1973) (citing *Montana v. Kennedy*, 366 U.S. 308 (1961)) (implying that the Government may be estopped if it had engaged in "misconduct").

However, in the wake of the Supreme Court's decision in *Hibi*, where the Court rejected, but entertained, an estoppel claim in the context of an immigration case – clearly a context where the Government is acting in its sovereign capacity – the sovereign/proprietary distinction was rejected by the Ninth Circuit in *United States v. Lazy FC Ranch*, 481 F.2d 985 (9th Cir. 1973), which held more broadly that estoppel would be available against the United States "where justice and fair play require it" even in cases where the Government had acted in its sovereign capacity. *Id.* at 988. In either case, however, whether the conduct at issue was undertaken by the Government in its

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[70] The court in *Harrison* found an estoppel defense both available and valid, on the basis that the FDIC had been acting in its "corporate" or proprietary capacity, that its agents had been acting within the scope of their authorities (though they had made inaccurate statements of fact and law that the party seeking estoppel had relied upon), and that all the elements of estoppel were otherwise proved. *See also* REW Enterprises, Inc. v. Premeir Bank, N.A., 49 F.3d 163 (5th Cir. 1995) (government activities undertaken primarily for the commercial benefit of the government are subject to estoppel); Deltona Corporation v. Alexander, 682 F.2d 888, 891 (11th Cir. 1982) ("Whether the defense of estoppel may be asserted against the United States in actions instituted by it depends upon whether such actions arise out of transactions entered into in its proprietary capacity or contract relationships, or whether the actions arise out of the exercise of its powers of government.")

sovereign or proprietary roles, the court has held it may only be estopped if such conduct was based on affirmative misconduct.[71] If the affirmative conduct test is met, the court will undertake a further balancing inquiry into whether, if the Government is not estopped, "serious injustice" will otherwise result, and the public's interest will not otherwise suffer "undue damage." Morgan v. Heckler, 779 F.2d 544, 545 (9th Cir. 1985). However, it appears the distinction between a sovereign and a proprietary act for purposes of applying the estoppel doctrine to the Government is relevant in the context of this balancing inquiry.[72] In other words, if the act is proprietary in nature, then it may be more likely that the court would find the public interest is less threatened by estopping the Government.

PPC, the IOUs, and NRU each commented on the issue of whether BPA was acting in a sovereign versus a proprietary capacity when it entered into the Block Contracts. PPC argues that when it sells power to a DSI, BPA is "attempting to discharge its unique agency role, and as such is not subject to concerns about estoppel based on its proprietary actions" and cites *United States v. Georgia-Pacific Co.*, 421 F.2d 92, 101 (9th Cir. 1970) and *Emery Mining Corp. v. Secretary of Labor*, 744 F.2d 1411 (10th Cir. 1984) (estoppel justified only where it does not interfere with underlying government policies or unduly undermine the correct enforcement of a particular law or regulation, and equitable estoppel may not be used to contradict a clear congressional mandate). PPC at 10-11. Likewise, NRU concludes that BPA was acting in its sovereign role when it signed the DSI contracts because: 1) BPA revenues are kept in the public treasury and the treatment of this money is subject to BPA's governing statutes; and 2) the Northwest Power Act specifically sets out the criteria by which BPA can sell power to the DSIs. NRU at 3-4.

PPC and the IOUs both compare BPA's role in power sales to the DSIs with BPA's role in administering the Residential Exchange Program (REP). The IOUs contend that there is "no relevant distinction" between BPA's role in the REP and power sales to the DSIs because "[i]n both contexts, BPA is subject to specified congressional directives." IOUs at 9. PPC believes that BPA is acting in a sovereign capacity both in the implementation of the residential exchange program and when it enters into a discretionary power sale with a DSI customer, because in both cases BPA is governed by "specific statutory limits" and is "bound to act in accordance with the specific Congressional directives that govern the transactions." PPCcx at 4.

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[71] *See* Wagner v. Fed. Emergency Mgmt. Agency, 847 F.2d 515, 519 (9th Cir. 1988); Rider v. U.S. Postal Serv., 862 F.2d 239, 240 (9th Cir. 1988); United States v. Ruby, 588 F.2d 697, 703 (9th Cir. 1978); Cal. Pac. Bank v. Small Bus. Admin., 557 F.2d 218, 224 (9th Cir. 1977); Sun Il Yoo v. Immigration & Naturalization Serv., 534 F.2d 1325, 1328 (9th Cir. 1976).

[72] *See* Santiago v. Immigration & Naturalization Serv., 526 F.2d 488, 496 (9th Cir. 1975) (Choy, dissenting) (citing *Lazy FC Ranch*, 481 F.2d at 989 n.5 (court may be more reluctant to apply estoppel against government when acting in its sovereign capacity)) (court has recognized that protection of public welfare and deference to Congressional desires is much more apt to outweigh hardships to private individuals in the equitable balance when estoppel is asserted against sovereign acts); Union Oil Co. of Cal. v. Morton, 512 F.2d 743, 748 n.2 (9th Cir. 1975).

As discussed in section IV.C above, BPA believes there are fundamental distinctions between its role in implementing the REP and its role when it makes discretionary sales to its DSI customers. The mere fact that BPA is subject to certain statutory requirements when exercising its authority to take both of these actions does not in itself compel a conclusion that both REP implementation and DSI sales are sovereign actions. In fact, with few (if any) exceptions, when an agency acts it necessarily does so pursuant to statutory authority. If the distinction has any validity, then it is difficult to imagine a governmental action containing more indicia of a proprietary act than the discretionary sale of electric energy by BPA, including such sales to the DSIs.

4. Elements of estoppel

Assuming the foregoing threshold tests are met for an estoppel defense to lie against the Government, then each of the traditional elements of estoppel as applied to any private litigant must also be met. The elements of estoppel in the Ninth Circuit are: 1) the party to be estopped must know the facts; 2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; 3) the latter must be ignorant of the true facts; and 4) he must rely on the former's conduct to his injury. *See, e.g., Lavin*, 644 F.2d at 1382. With respect to the reliance element, the Supreme Court has held that "the party claiming the estoppel must have relied on its adversary's conduct 'in such a manner as to change his position for the worse.'" *Heckler*, 467 U.S. 51, 59 (1984) (quoting Wilber Nat'l Bank v. United States, 294 U.S. 120, 124-125 (1935)).

5. Application of estoppel in this case

Given the threshold tests and the elements of estoppel described above, the questions then become: 1) whether the Administrator was acting within the scope of his authority when he signed the DSI Service RODs and authorized the sale to Clallam for resale to Port Townsend; 2) whether there was "affirmative misconduct" by BPA; 3) if there was affirmative misconduct, then for purposes of applying the balancing test, was BPA acting in its proprietary or sovereign capacity; 4) with respect to the balancing test, whether BPA's affirmative misconduct will cause a serious injustice, and whether the public's interest will not suffer undue damage by imposition of estoppel; and 5) if each of the foregoing is met, whether all of the estoppel elements are also met.

First, the Administrator was acting within the scope of his authority when he decided to serve Port Townsend, adopting the service construct laid out in the DSI Service RODs and executing the BPA/Clallam Contract to effectuate service to Port Townsend. As discussed in section IV.A above, the fact that *PNGC I* held BPA used the wrong rate in that contract does not mean the Administrator was acting outside the scope of his authority by entering into the Port Townsend transaction.[73]

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[73] *See also* Broad Ave. Laundry and Tailoring v. United States, 681 F.2d 746, 748-49 (Ct. Cl. 1982) (contracting officer found to have acted within scope of authority notwithstanding fact contracting officer's representations regarding availability of reimbursement were based on mistake of law).

Second, BPA does not believe its actions rise to the level of affirmative misconduct.[74] However, in light of some applicable case law, it appears that an argument can be made that misconduct for equitable estoppel purposes can be present when the Government acted on a basis that later turned out to be incorrect. If this somewhat diluted standard is applied, then a party may have a stronger argument that BPA's actions rise to the level of affirmative misconduct.

Third, while the "distinction between proprietary (private) and sovereign (governmental) functions is not often an easy one to make," *Georgia-Pacific*, 421 F.2d at 100 n.17, BPA believes comparing its role when making discretionary sales of surplus electricity to DSI customers to its role in administering the REP, a public benefits program mandated by statute, highlights the difference; the former is more akin to a proprietary activity, while the latter is more akin to the implementation of a regulatory or entitlement program, which are traditionally associated by the courts with a sovereign activity.[75] Therefore, even assuming there was affirmative misconduct by BPA (which BPA does not believe is the case), the court would likely conduct its balancing inquiry in the context of BPA acting in its proprietary capacity.

Fourth, it is unclear to BPA whether this is a case where the interest of Port Townsend in estopping BPA from – at least in part – unwinding the commercial transaction designed by BPA and seeking restitution, is outweighed by a broader public interest. However, as noted, BPA does believe a court would evaluate this issue in the context of the Government acting in its proprietary as opposed to its sovereign capacity, which would make it more likely the court would weigh the equities in favor of Port Townsend. Certainly, estopping BPA in a case involving a one-time transaction would seem to have no adverse precedential impact on the Government's operations, a consideration raised by some courts in weighing the relative equities. For example, the Supreme Court has noted the equities may favor the public in cases where estopping the Government based on its erroneous advice could result in the Government providing the public with informal or oral advice with respect to major benefit programs such as Social Security. *See, e.g.*, Schweiker v. Hansen, 450 U.S. 785 (1981).

Finally, as noted above, even if each of the threshold tests applied in cases involving estoppel of the Government are met (there was "affirmative misconduct," and the balance

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[74] In the draft ROD, BPA explained why it believed a stronger case could be made for the position that BPA's actions constitute affirmative misconduct. However, upon review of public comments and further review of applicable law, BPA believes that the risk is less than BPA originally posited.

[75] *See e.g.*, Auto. Club of Mich. v. Comm'r, 353 U.S. 180 (1957) (interpretation of tax statutes); Pac. Shrimp Co. v. United States, 357 F. Supp. 1036 (W.D. Wash. 1974) (enforcement of health and safety regulations); Gressley v. Califano, 609 F.2d 1265 (7th Cir. 1979) (grants of disability benefits); Hicks v. Harris, 606 F.2d 65 (5th Cir. 1979) (awards of student loans). It is also worth noting the Supreme Court has held that federal power is personal property, *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288 (1936), and as a general matter when BPA enters into power sales contracts it is subject to suit as if it were a private party. *See* Tucker Act, 28 U.S.C. § 1491 (2006). *But cf.*, Fed. Land Bank of St. Paul v. Bismarck Lumber Co., 314 U.S. 95 (1941) (when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of such corporation are governmental).

of interests favors the counterparty over the broader public interest), each of the four traditional elements of estoppel as applied to private parties must still be met. It appears the first three elements of estoppel would be met. First, BPA "knew the facts" related to the Port Townsend transaction: the fact the court found BPA misconstrued and misapplied its authorities does not mean BPA was ignorant of the "facts." *See, e.g.*, Johnson v. Williford, 682 F.2d 868, 872 (9th Cir. 1982) (Government held to "know the facts" associated with its conduct even though it misinterpreted or misapplied the statutory provision at issue in eight separate reviews). Second, BPA knew that Port Townsend would rely on the terms of that transaction, and BPA's actions surrounding the development and execution of the Block Contracts were such that Port Townsend had a right to believe its reliance was intended. Third, there does not appear to be any reason to think that Port Townsend knew (or could have known by any independent investigation) that the rate construct was illegal, or that Port Townsend should have known that BPA was required to make a determination that the transaction was consistent with sound business principles. Port Townsend reasonably relied on the analysis and conclusions regarding the legality of the transaction contained in the DSI Service RODs, signed by the BPA Administrator.[76]

To establish detrimental reliance, the party seeking to assert the estoppel defense must show that it changed its position from that which it would have otherwise occupied, for the worse. *Heckler*, 467 U.S. 51, 59 (1984) (citing 3 J. Pomeroy, *Equity Jurisprudence* § 805, p.192, and § 812 (S. Symons ed. 1941)). In other words, will Port Townsend be left in a worse position by virtue of the BPA/Clallam/Port Townsend transaction compared to the position it would have been in the absence of the transaction?[77] If BPA had not proceeded as it did using the illegal rate, it seems one of three things would have taken place instead: 1) BPA would have offered the transaction at the IP rate and Port Townsend would have accepted and operated; 2) Port Townsend would have purchased

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[76]In general those who deal with the Government are expected to know the law and may not rely on the conduct of Government agents contrary to law. *Heckler*, 467 U.S. 51, 63 (1984) (citing Fed. Crop Ins. Corp. v. Merrill, 332 U.S. 380 (1947)) ("this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority."). This is the source of the general rule that there can be no estoppel against the Government, and why the "affirmative misconduct" and proprietary function standards have been developed by some courts. However, in *Heckler*, the Court placed great emphasis on the informal oral nature of the erroneous advice provided to the contractor by the Government's agent, and emphasized the contractor's responsibility to ascertain the legal requirements of the reimbursement program at issue from the appropriate policymaking sources using the correct channels. 467 U.S. at 64. This rule has less impact, however, when those persons are dependent upon a governmental agency to interpret its own complex body of rules and regulations. *See* Cal. Pac. Bank v. Small Business Admin., 557 F.2d 218, 224 (9th Cir. 1977).

[77] Certainly, if Port Townsend is worse off as a consequence of the transaction, then presumably it must also be the case that it was not unjustly enriched. The two inquiries are distinct but related in the context of this case: unjust enrichment must be shown before BPA would be granted restitution, and detrimental reliance must be shown before Port Townsend could successfully interpose an estoppel defense. In fact, Port Townsend argues in its comments that it is worse off as a result of the transaction compared to the position it would have been in if BPA had sold it power at the IP rate. *See* Port Townsend at 8-10.

its power supply on the market and operated; or 3) Port Townsend would have not operated at all.

In *Heckler,* the Government was seeking restitution of overpayments made to a health care provider under Medicare. The court held that "[w]hen a private party is deprived of something to which it was entitled of right, it has surely suffered a detrimental change in its position. Here respondent lost no rights but merely was induced to do something which could be corrected at a later time." 467 U.S. at 62. The Court went on:

> There is no doubt that respondent will be adversely affected by the Government's recoupment of the funds that it has already spent. It will surely have to curtail its operations and may even be forced to seek relief from its debts through bankruptcy. . . . Respondent may need an extended period of repayment or other modification of the recoupment process if it is to continue to operate, but questions concerning the Government's method of enforcing collection are not before us. . . . Respondent cannot raise an estoppel without proving that it will be significantly worse off than if it had never obtained the [Medicare] funds in question.

Id. at 62-63. In fact, Port Townsend argues that it is already worse off – without even taking into account any amounts it would be required to pay BPA in the event BPA successfully pursued a restitution claim – by virtue of having entered into the BPA-Clallam-Port Townsend transaction, rather than simply having entered into a contract with BPA at the IP rate, or having not entered into any contract and shutting down operations. Port Townsend at 8-10.

6. Comments on equitable estoppel

PPC argues in its comments that equitable estoppel does not provide the DSIs with a viable defense to an equitable claim by BPA for restitution. PPC cites a number of cases in support of its contention: *Federal Crop Insurance Co. v. Merrill*, 332 U.S. 380, 383-84 (1947); *Office of Personnel Management v. Richmond*, 496 U.S. 414 (1990) (erroneous advice given by a government employee cannot estop the Government from denying benefits not otherwise permitted by law); *Sulit v. Schiltgen*, 213 F.3d 449, 454 (9th Cir. 2000) (estoppel against the Government is unavailable where petitioners have not lost any rights to which they were entitled); *McQuerry v. United States Parole Commission*, 961 F.2d 842, 846 (9th Cir. 1992) (mistake of law is not enough to estop government); *Falso v. Office of Personnel Management,* 116 F.3d 459, 460 (Fed. Cir. 1997) (Government cannot be estopped from denying benefits that are not permitted by law, even where claimant relied on mistaken advice of government official or agency). PPC at 8-9. PPC argues that in spite of what it calls a clear rule, BPA relied only upon "hints" from Ninth Circuit cases. *Id.*

PPC recites the elements of promissory estoppel, not equitable estoppel, and goes on to apply that standard to show why it would not succeed in this instance. PPC at 10-11 (citing *Morris v. Runyon*, 870 F. Supp. 362, 373 (D.D.C. 1992)). PPC seems to find

BPA's analysis, based on the elements of equitable estoppel, somewhat confusing, pointing to "BPA's erroneous application of the doctrine of estoppel," particularly with respect to the fourth element. PPC at 11. PPC also discusses BPA's description "in the Draft ROD that estoppel against the government requires proving additional elements beyond the traditional elements," including a showing of "affirmative misconduct" and consideration of "justice and fair play." *Id.* PPC argues that these additional elements cannot be satisfied. First, PPC maintains there was no affirmative misrepresentation or concealment of a material fact. Second, PPC concludes that the court would not invoke "justice and fair play" to "justify a contract that has been found unlawful." *Id.*

NRU essentially agrees with PPC's perspective, asserting that BPA cannot be estopped from seeking repayment from the DSIs. First, NRU believes that the threshold requirements to assert estoppel against the Government are not met: "It is well recognized that a party 'asserting estoppel against the government has a very heavy burden to bear'." NRU at 2 (citing Jones v. Dep't of Health & Human Servs., 843 F.2d 851, 853 (5th Cir. 1988)). NRU states that in order to assert equitable estoppel against the Government, the party must first establish "affirmative misconduct going beyond mere negligence." NRU at 3 (citing Wagner v. Director, Fed. Emergency Mgmt. Agency, 847 F.2d 515 (9th Cir.1988)). NRU contends that to find affirmative misconduct on the part of BPA, the DSIs would have to establish that "BPA affirmatively designed a contract that it believed would be overturned and knowingly withheld this information from the DSIs." NRU at 3. Moreover, NRU states that claims of estoppel can only prevail against the Government where "justice and fair play require it." NRU at 3 (citing Office of Pers. Mgmt. v. Richmond, 496 U.S. 414, 422 (1990); United States v. Lazy FC Ranch, 481 F.2d 985 (9th Cir. 1973)). NRU asserts that in this case, no injustice would result if the DSIs had to repay money that "they were not entitled to in the first place." NRU at 3.

The IOUs challenge BPA's assertion that DSIs would be better able to mount an equitable estoppel defense because BPA was acting in a proprietary capacity with respect to the DSIs and a sovereign capacity in administering the REP: "[T]here is no relevant distinction between BPA's roles in administering the residential exchange program and in setting rates for selling power to the DSIs. In both contexts, BPA is subject to specified congressional directives." IOUs at 9. The IOUs believe that "BPA should abide by the terms of the 'damages waiver' and 'invalidity clause' provisions in both the context of the REP Settlement Agreements and the 2007 Block Contracts – regardless of BPA's view as the strength of any estoppel defenses that the DSIs or the IOUs could raise in response to any effort by BPA to recoup alleged overpayments." IOUs at 9.

Alcoa and Port Townsend approach the issue differently. They seem to argue, in the first instance, that it would be unnecessary for either of them to rely on equitable estoppel as an affirmative defense, because BPA would be unable to make a showing of unjust enrichment, which is a predicate to BPA mounting a successful case for restitution. Port Townsend argues that unjust enrichment does not exist because Port Townsend's power costs actually increased due to BPA's decision to offer the BPA-Clallam Contract rather than providing 20.5 aMW of DSI service to Port Townsend at the IP rate. Thus, Port

Townsend asserts that in addition to not having a sustainable contract claim against it, BPA does not have a sustainable equitable claim against it. PT at 8. The elements of unjust enrichment are not met in this case, Port Townsend argues, specifically the requirement that "a benefit is conferred upon the defendant by plaintiff." *Id.* Port Townsend attempts to demonstrate that BPA's decision to offer the BPA/Clallam Contract actually cost Port Townsend approximately $600,000 more than it would have cost if BPA had agreed to supply Port Townsend directly with 20.5 aMW at the IP rate. PT at 9. According to Port Townsend, the increase in cost is due to: 1) Clallam's rate included state taxes that would not have been owed on a sale by BPA; 2) Clallam added an "other costs" recovery component to the rate it charged Port Townsend; and 3) Port Townsend had to supply the additional 3 aMW (above the 17.5 provided by BPA under the BPA-Clallam-Port Townsend transaction) at additional cost.

Alcoa argues that even if the damages waiver is not enforceable, BPA is not entitled to restitution against it, inasmuch as Alcoa can demonstrate that by paying net rates that greatly exceeded the IP, it paid rates substantially more than those required by law. Alcoa at 6. In response to BPA's request for parties to file comments "that provide factual and legal evidence that will assist BPA in making a final determination regarding whether a legal or equitable basis exists upon which BPA could pursue a Lookback claim for the Amendment Period against Alcoa, and if so, pursuant to what mechanism or process BPA could do so," Alcoa concludes there is no contractual basis for such a claim against it because there has been no breach of the Amendment, and there can be no claim for restitution by BPA because there has been no unjust enrichment since "Alcoa can demonstrate that by paying net rates that greatly exceeded the IP, it paid rates *substantially more* than those required by law." Alcoa at 5-6 (emphasis in original).

Alcoa claims that it only accepted the Monetary Benefit approach because BPA refused to provide physical power to Alcoa at the statutory IP rate. Alcoa at 7-8. This, Alcoa argues, supports their argument that the "equities are entirely in favor of Alcoa's retaining the Monetary Benefit payments, and indeed recouping its additional losses under the Monetary Benefit construct." Alcoa at 7. In an attachment to its comments, Alcoa shows that it purchased power at market rates which exceeded the IP rate. The cost of these power purchases was reduced only by the Monetary Benefit payments, resulting in net rates to Alcoa which exceeded the IP rate. Because the IP rate is the price that BPA should have charged Alcoa, and because the net effect of the transaction was that Alcoa paid a rate "significantly higher" than the statutorily-mandated IP rate, Alcoa concludes BPA cannot seek restitution of those payments.

Port Townsend also argues it could mount a successful equitable estoppel defense because it could show that it would be harmed by its prior detrimental reliance on BPA's contract. Port Townsend at 10. In response to BPA's question of whether or not Port Townsend could show that it detrimentally relied on BPA's representations regarding the legality of the BPA-Clallam-Port Townsend transaction, one of the elements of equitable estoppel, Port Townsend asserts that it could do so. As noted above, in the context of addressing the issue of unjust enrichment, Port Townsend states that its effective power costs under the BPA-Clallam-Port Townsend transaction were actually in excess of what

Port Townsend would have paid BPA had BPA simply sold 20.5 aMW at the IP rate directly to Port Townsend. If true, and BPA has no reason to believe it is not, then Port Townsend would appear also to have a valid argument that it "will be significantly worse off" if it is required to provide restitution to BPA, since it is already financially worse off under the transaction compared to the only possible alternative transaction, *i.e.*, at direct sale at the IP rate. *See Heckler*, 467 U.S. 51, 59 (1984). In addition, Port Townsend states that it suffered financial losses so severe that it had to struggle to stay open, and that it "reasonably relied on the power prices it obtained from Clallam and BPA in continuing to operate during this period." Port Townsend at 10. Presumably, Port Townsend means to say that if no alternative was offered by BPA in lieu of the BPA-Clallam-Port Townsend transaction – and none was – that it would have, at a minimum, mothballed operations and saved itself the losses it incurred during the Lookback period. In such a scenario, Port Townsend, without even taking into account any amounts it would be required to pay BPA in the event BPA successfully pursued a restitution claim – was put in a worse position by virtue of having entered into the BPA-Clallam-Port Townsend transaction, rather than simply having mothballed operations.

Finally, Port Townsend also believes that pursuit of claims against Port Townsend would be an unsound business practice. Port Townsend at 11. Port Townsend cites the substantial costs of litigation to recover a relatively limited amount of money as well as the "business cost of pursuing such dubious claims" as reasons that BPA should not pursue claims against Port Townsend. *Id.*

In cross-comments, ICNU rejects Port Townsend's argument that BPA, if anything, would owe it money. ICNUcx at 3. ICNU reasons that Port Townsend's assumption that BPA should have or would have served Port Townsend with 20.5 aMW under an alternative IP transaction, and not the 17.5 aMW actually provided under the BPA-Clallam-Port Townsend transaction, is faulty since BPA is not legally obligated to provide any amount of power to Port Townsend. *Id.* ICNU concludes that "BPA should seek refunds regardless of whether Port Townsend detrimentally relied upon its BPA's [sic] DSI contract decisions." *Id.* ICNU argues that Port Townsend's awareness that the contract was being challenged in the Ninth Circuit undermines its claim of detrimental reliance and that Port Townsend accepted the risk that it could be required to pay refunds. *Id.*

7. Evaluation of comments on unjust enrichment and equitable estoppel

BPA appreciates the comments of various parties on the issues of unjust enrichment and equitable estoppel. BPA believes that the facts of the instant case distinguish it from the reported cases evaluating the application of estoppel against the Government.

Unlike the cases described above, this is not a simple case of erroneous advice with respect to the application of a clear rule or regulation. Rather, the 2007 Block Contracts were the culmination of a large policy, legal, and contractual undertaking, involving a myriad of disputed issues regarding the scope and nature of BPA's fundamental power marketing authorities. BPA was called upon to identify, evaluate, and decide issues of first impression, each of which, in the first instance, is for the BPA Administrator to address and decide. BPA's actions were deliberate, and while ultimately found to be based on erroneous interpretations of law, were nevertheless carefully considered and taken in good faith. Under these circumstances, BPA does not believe it would be equitable to seek repayment from the companies, and that each company would attempt to raise *bona fide* arguments that BPA should be estopped from doing so based on its actions.[78]

PPC contends that the court would not invoke "justice and fair play" to "justify a contract that has been found unlawful." PPC at 11. PPC essentially argues that the Government cannot be estopped if the underlying action is inconsistent with statute. This interpretation would eliminate even the possibility of estoppel against the Government in many, if not most, cases, regardless of the equities, and is not consistent with the application of estoppel by the Ninth Circuit. For example, in *Johnson v. Williford*, 682 F.2d 868 (9th Cir. 1982), the court estopped the Government from revoking an individual's parole even though the court specifically held the convictions at issue clearly were not parole-eligible under the applicable statute.

Port Townsend's position essentially boils down to an assertion that it relied to its financial detriment on BPA's DSI service construct, and so can establish a valid estoppel defense. As noted, to the extent detrimental reliance can be established, there can have been no unjust enrichment (since a benefit would not have been provided), and so no basis for restitution would exist in the first instance. Port Townsend posits that the BPA-Clallam-Port Townsend transaction put it in a worse position, in and of itself and without even taking into account any obligation to pay BPA more money in restitution, compared to either of two likely alternative states. These alternative states would have been 1) mothballing the facility over the Lookback period, thereby saving the losses it actually incurred under the transaction; or 2) taking service at the IP rate for 20.5 aMW directly from BPA, in which case Port Townsend presumably would have broke even or made money. Port Townsend's comments present a plausible analysis supporting its conclusions under either scenario. To the extent Port Townsend's IP service scenario depends on an assumption that BPA would have provided it with 20.5 aMW, or 3 aMW more than provided under the BPA-Clallam-Port Townsend transaction, that assumption has some basis in the record.[79] Service to Port Townsend was not subject to any caps, but the amount of service to Port Townsend was limited to 17.5 aMW in light of the fact that such service (*i.e.*, the leg of the transaction under the BPA/Clallam Contract) was at a rate

[78] As noted, the Supreme Court has expressly declined to hold that the government may never be estopped. *See, e.g., Richmond*, 496 U.S. at 423. Thus, the lower courts are free to continue searching for a set of facts that will give rise to such a finding. Despite arguments to the contrary, BPA is convinced that the Ninth Circuit has historically been more liberal that most when parsing the elements of estoppel. Thus, BPA continues to believe that there is some tangible degree of risk that BPA could, under these facts, be estopped by Port Townsend, as well as each aluminum company, from asserting a claim for restitution.

[79]Having these 3 aMW served by BPA at the IP rate over the Lookback period would have provided a significant financial benefit to Port Townsend given the large delta between the cost to Port Townsend of serving those 3 aMW itself and having that load served by BPA at the IP rate.

below IP. It is reasonable to assume BPA would have provided Port Townsend with its full contract demand of 20.5 aMW if it had served Port Townsend directly and at the higher IP rate. In sum, BPA believes it is likely Port Townsend could establish that it detrimentally relied on BPA and that the service construct BPA insisted upon was not only legal but economically efficacious compared to the likely alternative states.

Assuming *arguendo* that an estoppel defense could not be interposed in this case, either because there was no affirmative misrepresentation or because there was no detrimental reliance, Port Townsend nevertheless makes a compelling case, as outlined above, that it was not unjustly enriched insofar as it derived no tangible benefit under the transaction as compared to the most likely alternative states. Even if it did derive some benefit, it is highly questionable whether it would in fact be unjust for Port Townsend, or for either of the aluminum companies, to retain such benefit under the circumstances surrounding the development of the 2007 Block Contracts. Nor does BPA believe the case law would necessarily support a claim of unjust enrichment in circumstances totally lacking in any fraud, duress, or other taking of an undue advantage by Port Townsend.[80] *See, e.g.*, United States v. Medica Rents Co., Nos. 03-11297, 06-10393, 07-10414, 2008 WL 3876307 (5th Cir. Aug.19, 2008) (citing LTV Educ. Sys., Inc. v. Bell, 862 F.2d 1168, 1175 (5th Cir.1989)) (restitution denied Government where counterparty performed its contractual obligations as directed by Government and there was no showing of fraud, duress, or the taking of an undue advantage).

Final Decision

While BPA is not precluded as a threshold matter from pursuing an equitable claim for restitution against Port Townsend, given the totality of the circumstances surrounding the development and implementation of the BPA-Clallam-Port Townsend transaction, it does not appear such a claim would ultimately prevail. Principally, Port Townsend has presented evidence supporting the conclusion that it has not been unjustly enriched. Port Townsend has made a compelling case that it ended up, in fact, worse off under the BPA-Clallam-Port Townsend transaction compared to the likely alternative states of mothballing operations or taking service directly from BPA at the IP-rate. In addition, even if Port Townsend did derive some benefit, it is highly questionable whether it would be unjust for Port Townsend, or for either of the aluminum companies, to retain such benefit under the circumstances surrounding the development of the 2007 Block Contracts. Nor does BPA believe the case law would necessarily support a claim of unjust enrichment in circumstances totally lacking in any fraud, duress, or other taking of an undue advantage by Port Townsend or the other DSIs.

BPA concludes, therefore, that on balance it should not pursue a claim for restitution against Clallam or Port Townsend.

[80] This observation applies also to the smelter contracts, including the Alcoa Amendment.

VI. CONCLUSION

For the foregoing reasons, based on the totality of the circumstances, including its evaluation of possible theories of recovery and interpretation of applicable law, BPA concludes that it does not have a viable legal or equitable Lookback claim against any of the DSIs, for any of the Lookback periods.

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/s/ Stephen J. Wright	*February 18, 2011*
Administrator and Chief Executive Officer	Date

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