

Administrator’s Draft Record of Decision On Issues Remanded to Bonneville Power Administration in *Pacific Northwest Generating Cooperative, et al., v. Bonneville Power Administration*, 580 F.3d 792 (9th Cir. 2009) (PNGC I) and *Pacific Northwest Generating Cooperative, et al., v. Bonneville Power Administration*, 596 F.3d 1065 (9th Cir. 2010) (PNGC II)

June 22, 2010

I. Introduction

On December 17, 2008, the United States Court of Appeals for the Ninth Circuit (the court or Ninth Circuit) issued its opinion in *Pac. Nw. Generating Coop., et al. v. Dept. of Energy*, 550 F.3d 846 (9th Cir. 2008), *amended on denial of reh’g*, 580 F.3d 792 (9th Cir. 2009) (*PNGC I*), a case involving the challenge by certain parties to Bonneville Power Administration’s (BPA’s) FY 2007 – 2011 direct service industrial customer (DSI) service construct and contracts (2007 Block Contracts or Block Contracts).¹ That case was superseded when the court revised the opinion in certain respects and denied petitions for rehearing. 580 F.3d 792 (9th Cir. 2009) (*PNGC I*).

In *PNGC I*, the court granted the petitions challenging BPA’s statutory authority to offer 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 have argued that as a consequence of this holding 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 from the DSIs (referred to herein generically as “the Lookback”).² 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 during the Lookback Period and, therefore, Alcoa is entitled to recoup those additional payments.³

¹ Historically, BPA served many DSI customers. BPA’s only DSI customers operating under the challenged contracts include two aluminum companies, Alcoa Inc., (Alcoa), with BPA service to Alcoa’s smelter in Ferndale, Washington, Columbia Falls Aluminum Company (CFAC), with BPA service to CFAC’s smelter in Columbia Falls, Montana, and one paper company, Port Townsend Paper Company (Port Townsend), with BPA service to the Port Townsend mill in Port Townsend, Washington.

²The Lookback for Port Townsend is addressed separately herein, and covers the 36-month period October 2006 through September 2009.

³As described below, BPA entered into an amendment to the 2007 Block Contract 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 basing payment on the IP rate. Certain parties filed petitions for review challenging the amendment with Alcoa, but no petition was filed on the amendment with CFAC. The court granted the petitions on the Alcoa amendment in *PNGC II*, and BPA terminated payments to Alcoa thereunder, 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.

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In addressing the contention by certain preference utility petitioners that the damages 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 Supplemental ROD.

Id. (emphasis in original). BPA did not address this issue in the ROD being reviewed by the court, 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.*

In a June 10, 2009, letter to the region regarding the *PNGC I* remand (prior to the issuance of *PNGC II*, discussed below), BPA identified the following issues on remand as 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 BPA for the benefit of Port Townsend, both during the Lookback Period and subsequently.⁴

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*.⁵

⁴ As discussed below, the damages waiver and severability provision analysis is applicable only to the Block Contracts by and between BPA and the smelters.

⁵ The June 10 letter is attached hereto as Attachment A. The letter proposed a bifurcated 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.

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Meanwhile, 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* opinion.⁶ A substantially similar amendment was entered into with BPA's other DSI aluminum company customer CFAC in March 2009.⁷ 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 *Pac. Nw. Generating Coop., et al., v. Bonneville Power Admin.*, 580 F.3d 828 (9th Cir. 2009), amended on denial of reh'g, 596 F.3d 1065 (9th Cir. 2010) (*PNGC II*). The *PNGC II* opinion was later revised and superseded in response to motions for rehearing. 596 F.3d 1065 (9th Cir. 2010) (*PNGC II*).⁸ 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 the Amendment was consistent with "sound business principles." *PNGC II* 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 incorrectly stated had been incorporated by reference into the Amendment. *Id.*⁹ 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.*

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

⁶ 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.

⁷No amendment was entered into with Port Townsend following *PNGC I*, inasmuch as BPA believed it could continue to provide physically delivered power to Port Townsend through the BPA/Clallam Contract, until such time as all petitions for rehearing were disposed of, and the mandate issued in that case.

⁸ Approximately one month earlier, on July 24, 2009, BPA issued a letter to the region delaying the publication of its draft record of decision on the Lookback. See Attachment B. BPA based the delay on the fact that the court had not yet disposed of certain petitions for rehearing in *PNGC I*, and also in light of the fact that the court had held, on an expedited basis, 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.

⁹Section 2(j) of the Amendment states that section 16(c) of the 2007 Block Contract (the damages waiver provision) is deleted for the term of the Amendment, December 1, 2008 through September 30, 2009.

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customers consistent with the court's newly revised opinions. BPA signed an approximately 13-month power sales contract with DSI customer Port Townsend (Contract No. 09PB-12106), and issued a record of decision regarding that contract, on November 13, 2009.¹⁰ BPA subsequently signed a power sales contract with Alcoa (Contract No. 10PB-12175), and issued a record of decision regarding that contract, on December 21, 2009.¹¹ No agreement has been reached with DSI customer CFAC.

BPA, Alcoa, and Port Townsend each filed petitions for rehearing in *PNGC II*. On March 2, 2010, the court issued an order and amended opinion, denying the petitions but amending its opinion in certain respects. *Pac. Nw. Generating Coop., et al., v. Bonneville Power Admin.*, 580 F.3d 828 (9th Cir. 2009), *amended on denial of reh'g*, 596 F.3d 1065 (9th Cir. 2010) (*PNGC II*). This draft record of decision (DROD) contains BPA's draft decisions with respect to the issues remanded to BPA in *PNGC I* and *PNGC II*.

II. Background

BPA issued two records of decision with respect to the contracts at issue in this remand.¹² 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), 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) (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 in aggregate 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.¹³ The 2005 ROD indicated that BPA would attempt

¹⁰ See Attachment C, *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 D, *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.

¹¹ See Attachment E, *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.

¹² In addition, on March 3, 2009, BPA issued a decision document titled "[BPA's] Response to Comments: CFAC Amendment (Effective Through September 2009)" in connection with the amendment with CFAC. BPA noted that inasmuch as the smelter amendments were substantially similar in all material respects, that the decisions and rationales in the CFAC record were applicable also to the amendment, signed several months earlier, with Alcoa. The Amendment Period Lookback is addressed below.

¹³ 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

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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, generated 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 annually) on each megawatt-hour allocated to each aluminum company. Nevertheless, the final decision regarding whether benefits would be provided through these financial 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 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 such eventuality.

In June 2006 BPA signed the three-party Block Contracts (Attachments F and G) for service to CFAC and Alcoa, and in August 2006 BPA signed a two-party agreement (BPA/Clallam Contract) (Attachment H) with Public Utility District No. 1 of Clallam County, Washington (Clallam) 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.

While the transactions between BPA and the aluminum companies share some similarities with the Port Townsend transaction, there are fundamental differences as well, not the least of which is the fact that BPA did not have a direct contractual relationship with Port Townsend.¹⁴ As a consequence, BPA has reviewed the aluminum

aMW allocation was subsequently reallocated to CFAC and Alcoa pursuant to the terms of the contracts. The non-aluminum DSI is Port Townsend Paper Company.

¹⁴However, Port Townsend is an intended third-party beneficiary to the BPA/Clallam Contract.

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company transaction separately from the Port Townsend transaction for purposes of the *PNGC I* remand.¹⁵

III. 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 the aluminum company DSIs Alcoa and CFAC for any overpayments of monetary benefits during the Initial Lookback Period; and 2) whether Alcoa is permitted to seek 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).

In evaluating whether the damages waiver provision is enforceable, it is not relevant, and BPA has not undertaken an analysis of whether or in what amount, BPA, CFAC, or Alcoa would have a claim in the event the waiver provision is not enforceable. As BPA indicated in the June 10 letter, this issue will be undertaken in a separate process in the event BPA concludes such claims are not otherwise precluded.

As noted above, the damages waiver provision in the 2007 Block Contract was not applicable during the Amendment period (December 1, 2008 through September 30, 2009), inasmuch as it was expressly deleted in the Amendments with both Alcoa and CFAC for that period. See Amendments, section 2(j). Therefore, this period will be addressed separately below in light of that fact.

1. Initial Lookback Period

The following discussion applies to the to the 26-month period (October 2006 – November 2008) commencing with the first monthly payment made to each aluminum

¹⁵ The 2007 Block Contract with Alcoa was terminated pursuant to the December 2009 Contract. See December 2009 Contract, section 23.1. The 2007 Block Contract with CFAC is not being implemented in light of *PNGC I*, but has not been replaced, or formally terminated. 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.

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.

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company under the 2007 Block Contract, through the last payment made by BPA to each company for the month prior to the issuance of *PNGC I*.

Issue 1: Is The Invalid Rate Term Severable And The Damages Waiver Provision Enforceable?

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.¹⁷ The damages waiver provision of the 2007 Block Contract (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 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.

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 Contract 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.” *PNGC I*, 580 F.3d at 826. In fact, the power sale conversion option cited by the court under the contract was not available, as it was relinquished by BPA when CFAC and Alcoa 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. The price of those purchases was used as the surrogate market price for calculating monetary benefits under the Block Contract.¹⁸

¹⁷ Whether BPA would be required as a matter of law to seek repayment from the aluminum companies (in the event it were not prohibited from doing so by application of the Block Contract damage waiver provision) is discussed below at footnote 43..

Nevertheless, 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 severing the invalid rate and amending or replacing the Block Contract to provide for a sale in FYs 2010-11 at a valid rate produces the same result contemplated by the court. In this instance, every other term of the Block Contract, including the damages waiver provision, would remain enforceable. 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. Amendment No. 1 (Contract No. 06PB-11744). As noted, BPA entered into a similar amendatory agreement with CFAC (Contract No. 06PB-11745).

BPA believes the Block Contracts and *PNGC I* each contemplate severing the invalid rate in the event the parties to the contracts agree to proceed using a valid rate, and that the remainder of the Block Contract, including the waiver provision, remains valid and enforceable. 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 monetized rate 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.” In such a scenario, the remainder of the Block Contract, including the waiver provision, survives.¹⁹

This conclusion is not changed by *PNGC II*, which involved a challenge to payments made by BPA to Alcoa during the period of the amendment, and not the 26-month period under the Block Contract prior to the amendment. 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

¹⁸ In exchange for relinquishing this option and allowing the companies to lock-in a market price, the monetary benefits paid to the companies was reduced by eight percent in FYs 2007-2009. See Block Contract section 6(c)(3).

¹⁹ See also *California Pacific Bank v. Small Business Administration*, 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 terms not violative of Sherman Act, and noting that courts should not be quick to create a policy of nonenforcement of contract beyond provisions which are clearly violative of statute).

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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."²⁰ *Id.* The court stated that its invalidation of the monetization formula "did not 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 Contract, to then require repayment by the companies to BPA of some or all benefits paid to date. Both CFAC and Alcoa are unlikely to operate during the FY 2010-2011 period *absent* an amended contract or replacement deal with BPA. Therefore, while the invalid portions of the monetization provisions can be severed, they have to be replaced with something else for the contract to work, and if BPA declines to amend or replace those provisions, each company is left with sunk costs, including a power supply that would likely be 1) too expensive to operate its smelter economically, and 2) above market on an annual average basis. This falls within the scenario which, as BPA explained in the 2006 ROD, it would be inequitable for BPA to seek restitution.²¹

²⁰The "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.

²¹ While the 2006 ROD addressed this side of the equation, the damages waiver provision applies to both parties, precluding both BPA and the companies from seek damages or restitution.

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As noted, Alcoa and BPA recently entered into a new power sales agreement commencing December 22, 2009, and BPA continues to discuss with CFAC a possible new sale to that company, inasmuch as CFAC has expressed a desire to continue operations for the remaining term of the 2007 Block Contract and beyond, if a satisfactory replacement arrangement can be made with BPA. These facts are relevant to the court's second, and for purposes of this remand critical, 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 the 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.²² 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 damages 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 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.²³

Beyond that, to the extent that the court believes that BPA's intent with respect to retaining an ongoing commercial relationship with its DSI customers, 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.

²² 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.

²³ In addition, even in the absence of a valid and enforceable damage waiver provision, it is not clear what basis BPA would have for a contract claim against the smelters to recover any illegal payments made under the Block Contracts. If the waiver provision did not exist or was not enforceable, it is probable that BPA's mechanism to recover any overpayments would be in equity, through recoupment or setoff, or through some other administrative action by BPA.

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Draft Decision

The court in PNGC I did not invalidate the Block Contract in its entirety, and indicated that it believed the invalid rate provisions were severable, leaving the remainder of the Block Contract intact, including the damages waiver provision. While the discussion of the damages 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. The damages waiver provision is enforceable by and against BPA.

Issue 2: Is A Determination Not To Seek Repayment From The Companies Consistent With BPA's Determinations Regarding The 2000 Residential Exchange Program Settlement?

In *Portland Gen. Elec., et al., v. Bonneville Power Admin.*, 501 F.3d 1009 (9th Cir. 2007) (*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 Nw. Aluminum, Inc. v. Bonneville Power Admin.*, 501 F.3d 1037 (9th Cir. 2007) (*GNA*), the companion case to *PGE*, the court held that BPA impermissibly allocated certain costs associated with the REP Settlement Agreements to the rates paid by its public preference customers, in contravention of the specific requirements of section 7(b)(2) of the Northwest Power Act, and remanded to BPA to "set rates in accordance with this opinion." *Id.* at 1053 BPA concluded that some manner of repayment or set-off was required with respect to the REP Settlement Agreements because it viewed "the logic and language of [*PGE* and *GNA*] as requiring retroactive relief for overcharges 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 WP-07S ROD, WP-07-A-05, p.22. While there is no equivalent of *GNA* at this time with respect to the Block Contracts (*i.e.*, a holding that public preference customer rates were improperly set in violation of specific statutory rate protection afforded the preference customers by the Northwest Power Act), BPA does not believe that is a valid basis for distinguishing any disparate treatment regarding repayment as between the REP Settlement and the Block Contract. Nevertheless, there appear to be at least two key distinctions between the *PGE* and *PNGC I* cases with respect to the damages waiver issue.

A. The 2000 REP Settlement Agreement Was Void

In the 2007 Supplemental Wholesale Power Rate Case Final Record of Decision (2007/S Final ROD), BPA stated that:

[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

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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.*

(emphasis added) 2007/S Final ROD at 178. In *PGE*, the court held that BPA lacked the authority to enter into the REP Settlement Agreements since they were inconsistent with section 5(c) and section 7(b) of the Northwest Power Act – and BPA concluded the agreements were *void ab initio* and invalid in their entirety as a result of that holding. As explained above under Issue 1, the court in *PNGC I* specifically stated it was not holding that the Block Contracts were void in their entirety, and the court 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. 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 *Cal. Pac. Bank v. Small Bus. Admin.*, 557 F.2d 218 (9th Cir. 1977); *Kelly v. Kosuga*, 358 U.S. 516 (1959). *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 damages waiver provisions.

B. Even If the Block Contracts Are Void Ab Initio, They May Be Distinguishable From the REP Settlement Agreements For Purposes Of The Lookback Analysis

Even if the 2007 Block Contracts are void in their entirety, so that the damages waiver provisions are of no force or effect, it is not clear, contrary to BPA’s determination regarding the REP Settlement Agreements, that BPA could seek restitution from the DSIs. A different result may be required as a consequence of the fundamentally different nature of the REP Settlement Agreements and the Residential Exchange Program (REP), as compared to BPA’s sale of surplus power, including to the DSIs under the Block Contracts.

Fundamentally, the REP is a statutory entitlement program under which the residential and small farm customers of certain investor-owned utilities in the Pacific Northwest receive a share of the public benefits generated by the Federal Columbia River Power System. The nature and form of the program, and the amount of these benefits, are defined in the first instance by statute. 16 U.S.C. §§ 839c(c)(1), *et seq.* To the extent such benefits are due and owing, pursuant to the applicable statutory provisions and BPA’s implementing policies and regulations, then they are paid by BPA, in the amount so provided. To this extent, purchase and exchange sales pursuant to the REP 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.

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Moreover, BPA's preference customers are protected from certain costs of the REP being included in their rates, through the rate ceiling established by section 7(b)(2) of the Northwest Power Act.

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 Enter., Inc. v. Premier Bank, N.A.*, 49 F.3d 163 (5th Cir. 1995).

In the REP lookback, BPA undertook to administratively recover the illegal REP payments after it determined that the damages 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). Inasmuch as 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, in a contract action, that BPA should be estopped from undertaking the lookback.²⁴

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. *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); but see *Wagner v. Fed. Emergency Mgmt.*

²⁴ Nevertheless, BPA was not unmindful of the risk that would attend an attempt to go to court to seek refunds from the IOUs. While the REP is, BPA believes, 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 Average System Cost determination processes, BPA's administrative offset approach achieves an equitable result.

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Agency, 847 F.2d 515, 519 at fn 4 (9th Cir. 1988), and *Rider v. U.S. Postal Serv.*, 862 F.2d 239 (1988) (holding that party must still show “affirmative misconduct” on part of government in all cases). Therefore, even if the Block Contracts are void and each of its provisions, including the waiver provisions, are of no force or effect, the DSIs may have grounds to successfully estop BPA from attempting to recover any overpayments made during the Initial Lookback Period.

While BPA believes the draft decisions with respect to the threshold contractual issues under Issue 1 above are dispositive, BPA asks that parties specifically address the issue of estoppel in their comments to this draft record of decision.

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) has been properly applied. The 2007/S Final 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.*

(emphasis added) 2007/S Final ROD at 180. For the reasons discussed above, BPA believes the contractual analysis in the case of the 2007 Block Contracts leads to a different conclusion. However, BPA also has greater flexibility, even in light of *PNGC I* and *PNGC II*, with respect to the level of service benefits it may provide to the DSIs compared to what benefits it *must* provide to residential and small farm consumers through the IOUs 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 proposed a benefit level less than or greater than this amount if it believed that a lower amount was sufficient, or that a higher amount was required, 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, and consistent with sound business principles, as that requirement has now been defined by the court.²⁵ In the case of the Block Contracts, while *PNGC I* held BPA used an invalid rate to calculate benefits paid

²⁵ 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, and CFAC’s contract demand equals approximately 416 aMW. See also 16 U.S.C. §§ 839c(d)(1)(B), (d)(3).

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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 that the balance between containing costs and providing an appropriate level of service benefit to the DSIs was best achieved by committing to 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 would, on a forecast basis, accrue net revenues equal to or greater than the forecast costs of such sale. See Attachment E 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*.²⁶ Among other things, BPA requested panel rehearing on the issue of whether *PNGC II*:

[C]onflicts with the 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.²⁷ The petition was 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 addressing the circumstances under which a discretionary surplus power sale may be in

²⁶ 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.

²⁷ 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 of “sound business principles.” Intervenor Alcoa Inc.’s Petition for Panel Rehearing and Suggestion for Rehearing En Banc.

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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.

Pac. Nw. Generating Coop., et al., v. Bonneville Power Admin., 580 F.3d 828 (9th Cir. 2009), *amended on denial of reh'g*, 596 F.3d 1065 (9th Cir. 2010) (*PNGC II*).

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 E 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 done so in a number of different ways, including by allocating additional megawatts to serve the companies loads (up to their respective contract demands), 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, or through some combination of the foregoing.

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.²⁸ 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 2005 ROD at 9-12. However, BPA also decided that, with respect to separate aluminum company proposals increasing the amount of benefits without imposing any cap:

²⁸Arguably, "underpayments" - or in the context of a physically delivered sale the value of an IP sale compared to market prices - would not be possible in the context of a discretionary, physically delivered sale at the IP rate.

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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 levels 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.

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A fundamental difference between the DSI Block Contracts and the 2000 REP Settlement Agreement is that with respect to the latter BPA concluded it had paid more benefits to the IOUs than they were entitled to receive under law and thereby imposed more REP costs on the preference than were legally permitted. Therefore, it was necessary for BPA to recover such overpayments and return an appropriate amount to preference customers. In the case of the DSI contracts, BPA cannot conclude that it incurred costs that are not legally sustainable for providing DSI service. Thus, it cannot be concluded that preference customers are entitled to a refund pursuant to specific statutory violation. The court in PNGC I did not invalidate any rate used to calculate the actual level of benefits paid, nor did it invalidate BPA’s decision to provide the aluminum companies with up to \$59 million annually in benefits. The Court found in PNGC I that BPA had used the incorrect rate and that its decision to serve the DSIs must comport with sound business principles. Therefore, any extra-contractual legal or equitable theories that might otherwise provide support for an argument that BPA can or must seek repayment from the DSI smelter companies are arguably inapplicable. As long as BPA demonstrates it would have been in its business interest to provide a benefit level, in the form of physically delivered power, to the companies equal to or greater than the \$59 million it decided on in the DSI Service RODs, then such service would be lawful. The DSI Service RODs support the conclusion that even if it had based the companies’ transactions on the IP rate, 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.

2. Amendment Period Lookback

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

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was the only modification required by *PNGC I* in order to continue the transaction. Upon issuance of *PNGC II*, which held that BPA must also make a determination that such a sale was 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 damages waiver provision) for the term of the Amendment.²⁹ 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 *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, inasmuch as parties had argued these waiver provisions were unlawful, it seemed 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 necessarily BPA's intent by removing the waiver provision to seek repayment in such event. In fact, BPA believes the same policy rationale for not seeking a refund, as outlined in this draft record and in the DSI Service RODs, also applies to the Amendment period.

As explained below, 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. 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. *Id.* In contrast to the REP Settlement – which was found by the court to be beyond BPA's authority and therefore not enforceable under any circumstances – it is likely (though not a certainty) 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.³⁰ 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.

²⁹ 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.

³⁰ See generally, Attachment E 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 power it had previously purchased to serve its load.

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However, assuming BPA would determine the Amendment did *not* further its business interest, the questions for the remand, at this point, are whether there is a legal or equitable basis on which BPA could seek a refund, and if so, what mechanism is available for recovery.³¹

Notwithstanding the fact the Amendment contains no waiver, by either party, of any right to seek a refund or damages as a result of the court's decision in *PNGC II*, it is not clear, precisely, what contractual basis BPA would have 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 contract based solely on *PNGC II*.

BPA possibly could pursue an extra-contractual or equitable claim for restitution based on an unjust enrichment theory; but 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 at section B, above, and in the estoppel analysis outlined at Issue 2, below, where the elements of such a claim are outlined in the context of the Lookback with respect to Port Townsend, and BPA specifically invites parties to comment on whether such a claim could or should be pursued against Alcoa.

BPA could, akin to a setoff, seek to administratively recover payments made to Alcoa under the Amendment by proposing an upward adjustment, or surcharge, to the IP rate, or any other power rate used in connection with any future power service to Alcoa. This raises a number of issues as well, including the basis for such an adjustment to the rate applicable to DSI service, which the court has made clear to BPA is, in the first instance, the IP rate, to be established in accordance with section 7(c) of the Northwest Power Act.³²

BPA specifically invites 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 for the Amendment Period against Alcoa, and if so, pursuant to what mechanism or process BPA could do so.

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³¹ Or as expressed by the court in remanding to BPA, "whether and how it will seek a refund from Alcoa." *PNGC II* at 846.

³² Arguably, BPA has already recouped some or all of any illegal overpayments under the Amendment – as measured against a level of benefits that BPA may have found could be provided to Alcoa consistent with BPA's business interest in preserving DSI load - by withholding payments to Alcoa for the final two months of the term of the Amendment.

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While the Amendment does not contain a damages waiver provision precluding BPA from seeking a refund from Alcoa, PNGC II does not appear to require that BPA seek a refund, and it is not clear to BPA that it would have a contractual or equitable basis on which it could successfully seek a refund. As noted elsewhere in this draft record, BPA believes it is in its long-term business interest that some level of DSI load remain operating in the region, so that it is likely BPA would have found some level of continued service to Alcoa after PNGC I to be in its business interest.

IV. Port Townsend Transaction

With respect to the transaction BPA entered into with Clallam for the benefit of Port Townsend, BPA posited in its June 10 letter that the fundamental threshold issue was 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 differs 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. See Attachment G. 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 H. Unlike the Block Contracts, there is no waiver provision directly and expressly applicable to BPA that would prohibit BPA from seeking refunds against Port Townsend, although it seems any contract claim for recovery would have to be made through Clallam, since BPA and Port Townsend are not parties to a contract.³³

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). However, the facts may support some limited reduction of any refund amounts that may otherwise be owing.³⁴

³³ As noted earlier, each contract has been terminated, but liabilities and obligations are preserved until satisfied.

³⁴ 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

Issue 1: Assuming A Refund Amount Would Otherwise Be Found To Be Owning By Port Townsend, Does The BPA/Clallam Contract Provide A Mechanism For BPA To Seek and Recover Such A Refund?

A. PNGC I Held BPA Provided An Illegally High Subsidy To Port Townsend Through Clallam.

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 that there were two contracts comprising the overall transaction, the court's discussion basically conflates the two contracts in its analysis, 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*, 580 F.3d 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".³⁵ 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 intended to work together, and that neither would continue to stand alone absent the continued operation of the other. See BPA/Clallam Contract, second recital, section 5, section 13(f); Clallam/Port Townsend Contract, fourth recital, section 4, section 14.³⁶

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

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.

³⁵ 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 879; see also *PNGC I* at 879, footnote 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 shorthand for the overall transaction, looking at the contracts as a piece. Also, in footnote 41 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 . . .").

³⁶ See also 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.

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through Clallam, below-IP rate BPA power. In addition, in footnote 41 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.”³⁷ 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 an improperly high subsidy, albeit indirectly, the court essentially invalidated the totality of the transaction. The fact that Port Townsend was made an intended third-party beneficiary to the BPA/Clallam Contract would seem to cement the connection.

Therefore, there appears to be no room for an argument that *PNGC I* does not contemplate the possibility of BPA seeking a refund from Port Townsend, on the basis that the court’s holding applies only to the validity of a sale by BPA to Clallam.³⁸

B. While Neither the BPA/Clallam Or 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 the benefits of use of the wrong rate from BPA, BPA does not have a direct contractual relationship with Port Townsend, apart from Port Townsend’s intended third-party beneficiary status under the BPA/Clallam Contract, which only gives Port Townsend certain rights to enforce the respective obligations of BPA and Clallam under the BPA/Clallam Contract. The Clallam/Port Townsend Contract provides that the parties intended there be no “direct or indirect” third-party beneficiaries to that contract (section 13(f)). There does not appear to be any basis for BPA to argue that it is an incidental 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.³⁹

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), and if such refund is effected contractually (opposed to some extra-contractual mechanism such as an equitable claim for restitution), then it appears the refund would have to be sought through the BPA/Clallam Contract. There does not seem to be anything in either the BPA/Clallam Contract or in *PNGC I* that would prohibit BPA seeking a refund against

³⁷ 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.”

³⁸In the context of this discussion, “refund” refers generically to additional payments for BPA power delivered to Port Townsend through Clallam during the Lookback period.

Port Townsend through the BPA/Clallam Contract, unless the BPA/Clallam Contract is *void ab initio*, which does not seem consistent with the holding in *PNGC I*.⁴⁰

However, while there does not seem to be anything 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.⁴¹ 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. It is likely that both Clallam and Port Townsend could raise valid contractual or other arguments against such back-billing.

While the principal holding in *PNGC I* is that BPA provided an illegal benefit to Port Townsend through Clallam, this holding necessarily includes the holding 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 received 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 expensive litigation and without otherwise incurring any financial exposure. As noted above, BPA believes that Clallam simply billing Port Townsend would be insufficient to achieve such a result.

⁴⁰ At the conclusion of its discussion of the Port Townsend transaction, the court held that “[w]e therefore hold that the Clallam/Port Townsend contract is *also* invalid.” *PNGC I* at 879 (emphasis added). The court based its holding on the same essential rational it used to invalidate the Block Contracts, thus the inclusion of the word “also.” But the court made clear that it was not holding the Block Contracts void (*PNGC I* at 882) – so if the rational for the holding with respect to the Port Townsend transaction is the same as the court used for the Block Contracts, then the conclusion should be that the BPA/Clallam Contract is “invalid” to the same extent as the Block Contracts, i.e., it uses the wrong rate but is otherwise a valid exercise of BPA’s authority to sell power.

⁴¹ 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-07-A-05, Ch. 2, p. 23. Here, unlike in the REP lookback, no new rates need to be developed, BPA would merely apply the posted IP rates for the period applicable to the Lookback.

C. The Logic For The Waiver In the Block Contracts Also Applies To The Port Townsend Transaction.

As the court noted, unlike the aluminum smelter contracts, the damages 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 the issue. 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 “otherwise enforceable” as written. This rationale appears to apply equally to the Port Townsend transaction in the circumstances. The Clallam/Port Townsend Contract (see section 14) does contain a waiver by Port Townsend of any damage claims against Clallam in the event the BPA/Clallam Contract is terminated. 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*.⁴²

The only reason BPA did not offer a waiver to Clallam in the BPA/Clallam Contract is because 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

Draft 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, neither is it 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 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

⁴² It does not seem there have been any such damages – Port Townsend continued to operate under the terms of the original transaction pending issuance of the mandate in *PNGC I* – so any “damage” could only be in the form of refunds it may owe.

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 A Refund From Port Townsend, Could BPA Successfully Pursue A Refund Directly Against Port Townsend?

While the BPA/Clallam Contract may not – either as a practical or legal matter – be available as a vehicle to pursue a refund against Port Townsend, BPA may have other recourse to seek a refund by other means. Because BPA is not a party to a contract with Port Townsend for the service period commencing in September 2006 (see BPA-Clallam contract, Contract No. 06PB-11694, Attachment H), the question arises whether BPA is able or is legally required by *PNGC I* or other applicable law to pursue a refund directly against Port Townsend based on some other legal or equitable theory such as restitution.

BPA concluded that a refund was required (in the form of set-offs against future benefits) with respect to the REP Settlement Agreements because it viewed “the logic and language of [*PGE* and *GNA*] as requiring retroactive relief for overcharges 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 WP-07S ROD, WP-07-A-05, p. 22. While that case can be distinguished from *PNGC I* inasmuch as there is no equivalent of *GNA* here (*i.e.*, there is no holding at this time that the public customers’ rates were improperly high due to the invalid rates in the DSI contracts), and the court in *PNGC I* specifically noted it lacked jurisdiction over any claims regarding rate impacts at this time, for purposes of this remand BPA will assume *arguendo* that if and when presented with the appropriate rate challenge, the court would make a similar finding to the one it made in *GNA*, *i.e.*, that the PF rate was impermissibly high as a result of BPA providing its non-preference customers with a level or type of service beyond what is permitted by statute.

However, BPA is unaware of any other legal authority for the proposition that BPA would be required to seek a refund, or restitution, in a circumstance such as this, and so the question appears to boil down to whether BPA should pursue a refund against Port Townsend because it did so against the IOUs, or whether there is a basis for treating this case differently.⁴³

⁴³ BPA is aware that there is at least one case holding that: “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.” *Fansteel Metallurgical Corp. v. United States*, 172 F.Supp. 268, 270 (Ct.Cl. 1959). As authority for this conclusion *Fanstell* cites generally *Royal Indemnity Co. v. United States*, 313 U.S. 289 (1941), but it is not clear that *Royal Indemnity* held that the government is duty bound to seek restitution for payments erroneously or illegally made, and even if it did it appears the case can be distinguished on the grounds that payments made by BPA from the BPA Fund do not implicate the constitutional considerations cited in *Fansteel*. In

A. Claim For Restitution

“Restitution” basically 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); WILLISTON ON CONTRACTS § 68:1 (4th ed.)(quasi-contractual liability is imposed independent of any express contract, provided the subject matter of the dispute is not covered by an express contract).⁴⁴ 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.

Therefore, assuming there is no express contract covering the subject matter here, a contract implied at law (or quasi-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. *See Int’l Air Response v. United States*, 75 Fed.Cl. 604 (Ct.Cl. 2007). These are the elements needed to show unjust enrichment, which is a prerequisite to a successful claim for restitution.⁴⁵ It seems clear the first two elements would be met in the case of Port Townsend, with the more difficult question being whether the third element would be

any case, even if the rule articulated in *Fansteel* applies here, a duty to seek restitution and the right to restitution are different things, and if BPA concludes it has no right to restitution – either because it has not met the elements required for restitution, or because it is otherwise estopped from making such a claim – that should end the matter. However, it is true that the government has the “inherent authority” to recover sums illegally or erroneously paid. *Aetna Casualty v. United States*, 526 F.2d 1127 (Ct.Cl. 1975); *United States v Wurts*, 303 U.S. 414 (1938) (holding that the government can “by appropriate action recover funds which its agents have wrongfully, erroneously, or illegally paid” and that no separate statutory authority to do so is required.)

⁴⁴The 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 & Assoc., Inc. v. Kalitta Flying Servs., Inc.*, 958 F.2d 896 (9th Cir. 1992).

⁴⁵*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) (federal law)

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.

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 means that under the circumstances it would be inequitable for Port Townsend to retain those benefits. Predictability and finality are important to commercial transactions such as this, so it should be presumed that in the absence of explicit arrangements otherwise, parties would be left where they are in terms of past burdens and benefits. BPA is mindful that, at least implicitly, it concluded that retention of overpayments to the IOUs under the REP Settlement Agreement would have been inequitable under the circumstances. That conclusion, though, was very much influenced by the public benefits nature of the REP program. However, assuming 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. The REP Settlement Lookback Can Be Distinguished Based On The Conclusion That Port Townsend Could Successfully Assert An Equitable Estoppel Argument 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 use against the government under any circumstances. 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 409.⁴⁶ This rule has been applied in numerous cases, and while it does

⁴⁶ 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 Personnel Mgmt, v. Richmond*, 496 U.S. 414, 433 (1990) (estoppel claims

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 Mgmt. v. Richmond*, 496 U.S. 414, 433 (1990); *Heckler v. Cmty. Health Servs. 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); *INS 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” exception, see *Lavin v. Marsh*, 644 F.2d 1378 (9th Cir. 1981), 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.

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).⁴⁷ The use of the word “misconduct” in the term “affirmative misconduct” is somewhat confusing, because while the standard does require 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 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).⁴⁸ The standard, however, appears to require more than the government, through its agents, formally or informally, carelessly or negligently providing incorrect information; rather it requires conscious and deliberate conduct, or “ongoing active misrepresentations” by government officials “acting well within their

would permit endless litigation over both real and imagined claims by citizens of government misinformation, creating an unpredictable drain on public fisc).

⁴⁷ 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 II Yoo v. INS*, 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 government is acting in a capacity that has traditionally been described as sovereign (as distinguished from proprietary) although we may be more reluctant to estop the government 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, fn 6.

⁴⁸ But see, *Mukherjee v. Immigration and Naturalization Service*, 272 F.2d 1006 (9th Cir. 1986) (estoppel denied in absence of “deliberate lie” or “pattern of false promises”).

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 and Naturalization Service 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).

3. Proprietary Versus Sovereign Activities

The general rule against estoppel, together with the “affirmative misconduct” exception, 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”).⁴⁹

Early Ninth Circuit cases exploring the boundaries of estoppel against the government hewed closely to this proprietary/sovereign distinction. 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, although it appears to have been introduced by the Supreme Court in *Immigration and Naturalization Serv. v. Hibi*, 414 U.S. 5, 8 (1973) (citing *Montana v. Kennedy*, 366 U.S. 308 (1961)) (implying that government may be estopped if it had engaged in “misconduct”).

However, in the wake of 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*, which

⁴⁹ 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.”)

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. 481 F.2d 985, 988 (9th Cir. 1973) In either case, however, whether the conduct at issue was undertaken by the government in its sovereign or proprietary roles, the court has held it may only be estopped if such conduct was based on affirmative misconduct. 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 and Naturalization Serv.*, 534 F.2d 1325, 1328 (9th Cir. 1976).

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. See *Santiago*, 526 F.2d 488, 496 (9th Cir. 1975) (Choy, dissenting) (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) (citing *Lazy FC Ranch*, 481 F.2d at 989 fn. 5 (court may be more reluctant to apply estoppel against government when acting in its sovereign capacity), and *Union Oil Co. of Cal. v. Morton*, 512 F.2d 743, 748 n.2 (9th Cir. 1975)). 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.

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 foregoing, 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

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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 the public’s interest will not suffer undue damage by imposition of estoppel; and 5) if each of the foregoing is met, whether each of the estoppel elements is 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. 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.⁵⁰

Second, in light of Ninth Circuit case law, it appears that a *bona fide* argument can be made that BPA’s conduct in developing, proposing, evaluating, implementing, and defending the DSI service construct rises to the level of affirmative misconduct, as that term has been interpreted and applied by the court. (As indicated earlier, the conduct need not be done with a purpose to mislead; rather, misconduct for equitable estoppel purposes can be present when the government acted on a basis that later turned out to be incorrect.) For better or worse, BPA was the chief architect and proponent of the DSI service construct that resulted in the Block Contracts and the Port Townsend transaction, and this fact is borne out by the DSI Service RODs and accompanying record. Clearly, BPA acted affirmatively in advancing the DSI service proposal, including its position that the construct and contracts implementing it were legal.

While it was just as clearly not BPA’s intent to mislead parties with respect to its authorities or the legality of the transactions, each of the two DSI Service RODs, signed by the BPA Administrator, reflect the agency’s considered, though erroneous in the view of the *PNGC II* court, interpretation of its statutory authorities. This was not a case of a party unreasonably relying on the advice of an agent of the government, one who may or may not have been acting within the scope of his authority; rather, the DSI service construct was conceived by BPA and formally adopted by the BPA Administrator in records of decision following an extensive public process. The Ninth Circuit in *Lazy FC Ranch* noted 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.” *Lazy FC Ranch*, 481 F.2d at 990 n.6; see also *United States v. Rossi*, 342 F.2d 505 (9th Cir. 1965) (no estoppel where agent acting outside scope of his authority).

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

⁵⁰See also *Broad Ave. Laundry and Tailoring v. United States*, 681 F.2d 746, 748-749 (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).

(1970), as described in greater detail above, 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.⁵¹ Therefore, assuming there was affirmative misconduct by BPA in this 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, 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. BPA asks that parties to provide comments with respect to this balancing test in their comments.

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 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 engineered the service construct adopted in the DSI Service RODs and implemented through the Port Townsend transaction, and so clearly “knew the facts;” second, BPA knew that Port Townsend would rely on the terms of that transaction; and 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 proposed by BPA for the transaction was illegal. Port Townsend’s reasonably relied on the analysis and conclusions regarding the legality of the transaction contained in the DSI Service RODs, signed by the BPA Administrator.⁵²

⁵¹ 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. Tenn. Valley Auth.*, 297 U.S. 288 (1936), and as a general matter when BPA enters into power sales contracts it is subject suit as if it were a private party. See Tucker Act, 28 U.S.C. §1491. *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).

⁵²In 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 harsh general rule that there can be no estoppel against the government, and why the “affirmative misconduct” and proprietary function exceptions 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 contractor by the government’s agent, and emphasizing the contractor’s responsibility to ascertain the legal requirements of the reimbursement program at issue from the appropriate policymaking sources using the correct channels. *Heckler*, 467 U.S. at 64.

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Whether the final element (detrimental reliance) is met here is less clear. This element requires that the party have 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 Port Townsend transaction compared to the position it would be in absent the transaction. 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 its power supply on the market and operated; or 3) Port Townsend would have not operated at all.

Assuming that Port Townsend would have requested that BPA do the transaction at the IP rate, it is not clear that Port Townsend is put in a *worse* position if it is required to pay BPA restitution for benefits received in excess of the benefit level provided by statute. Rather, it seems the effect would be to put Port Townsend in the same position it would have been if BPA had used the legal rate. Its only detriment is the inability to retain benefits that it should never have received in the first place. 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. 51, 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. Likewise, inasmuch as market prices over the Lookback period exceed the applicable rate paid by Port Townsend for the same period, it is not clear that Port Townsend will be in a worse position because it entered into the transaction with BPA and Clallam compared to having purchased its power supply at market. Nor is it clear the last element could be met if it is assumed Port Townsend would not have operated at all absent the impermissibly low rate, unless it can be shown that by ceasing operations Port Townsend would have avoided liabilities and obligations which were incurred in reliance on the availability of below-IP power.

However, these observations are speculative, and BPA will await party’s comments in order to fully evaluate this issue.

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Draft Decision

While it appears BPA could assert an equitable claim for restitution against Port Townsend, it is not clear that Port Townsend was unjustly enriched and that it would be inequitable in the circumstances for Port Townsend to retain the benefits received in excess of those permitted by statute. However, even assuming that it was determined Port Townsend was unjustly enriched, Ninth Circuit case law provides for equitable estoppel defenses against the United States where the government has engaged in affirmative misconduct, on balance the equities favor application of estoppel, and the elements of an estoppel defense are met, but it is not clear that Port Townsend could meet the detrimental reliance element of estoppel. BPA lacks sufficient information to make even a draft determination regarding whether Port Townsend would likely meet the last element of the traditional estoppel test required to successfully interpose an estoppel defense against a restitution claim by BPA, and so will not make a draft determination, but will evaluate this issue further after receiving comments from parties, and then make a final decision in the final record of decision.