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June 30, 2014

Mr. Carl A. Monroe  
Executive Vice President and Chief Operating Officer  
Southwest Power Pool, Inc.  
201 Worthen Drive  
Little Rock, AR 72223

Re: Western Area Power Administration "Federal Service Exemption"

Dear Carl:

You have asked us to review the Western Area Power Administration's ("Western") rationale, as expressed in a recent letter from Western to SPP concerning its future membership in SPP, for requesting revisions to the SPP Open Access Transmission Tariff ("Tariff") and other governing documents to establish a "Federal Service Exemption" ("FSE") from certain charges under the SPP Tariff.<sup>1</sup> As discussed below, based on our review of Western's letter, it is reasonable to conclude that, while the statutes governing Western do not explicitly require that Western be excluded from SPP's normal transmission usage charges, Western's interpretation of its obligations to its customers under its own governing statutes appears reasonable. The Federal Energy Regulatory Commission ("FERC") would likely find the FSE to be a just and reasonable accommodation to enable Western's participation in SPP, given the FERC's strong policy preference of encouraging public power entities to participate in Regional Transmission Organizations ("RTOs") and the FERC's grant of similar carve-outs to other pre-existing service arrangements such as those reflected in so-called grandfathered agreements.

The Western Letter "explain[s] the statutory underpinnings of [Western's] rationale for requesting the FSE" to be exempt from congestion and marginal loss charges in the SPP Integrated Marketplace and charges assessed under Schedule 11 of the SPP Tariff for regional transmission expansion costs.<sup>2</sup> According to Western, the requested FSE would apply only to delivery of generation from Western's Federally-owned resources to Western's statutory loads

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<sup>1</sup> Letter from Mr. Ronald J. Klinefelter, Assistant General Counsel, Western Area Power Administration, to Mr. Carl Monroe, Executive Vice President and Chief Operating Officer, Southwest Power Pool, Inc. (May 20, 2014) ("Western Letter").

<sup>2</sup> *Id.* at 1.

(and not “for purchases from, or sales into, the SPP Integrated Marketplace”).<sup>3</sup> Western states that it “has interpreted its statutory requirements within the SPP construct as requiring an exemption from market charges related to congestion and marginal losses, as well as an exemption from Schedule 11 regional cost expansion allocations for delivery of its Federal Power-Western UGP to its Statutory Load Obligations.”<sup>4</sup>

Section 1232 of the Energy Policy Act of 2005 (“EPAAct 2005”) provides for participation in a “transmission organization” like SPP<sup>5</sup> by a federal power marketing agency like Western. Subsection (c) of section 1232 sets forth requirements for contracts for the transfer of control and use of a federal power marketing agency’s transmission system to a transmission organization. Specifically, subsection (c) requires that such an agreement must include:

- (1) performance standards for operation and use of the transmission system to ensure recovery of all of the costs and expenses of the Federal utility related to the subject transmission facilities, consistency with existing contracts and third-party financing arrangements, and consistency with the statutory authorities, obligations, and limitations of the Federal utility;
- (2) provisions for monitoring and oversight by the Federal utility of the Transmission Organization’s terms and conditions of the contract, agreement, or other arrangement (including dispute resolution through arbitration or other specified means); and
- (3) a provision that allows the Federal utility to withdraw from the Transmission Organization and terminate the contract, agreement, or other arrangement in accordance with its terms.<sup>6</sup>

Subsection (d) of section 1232 states that participation by a federal power marketing agency in a transmission organization will not confer upon FERC jurisdiction over: the electric generation assets, electric capacity, or energy of the Federal utility that the Federal utility is authorized by law to market; or the power sales activities of the Federal utility.<sup>7</sup>

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<sup>3</sup> *Id.* Western states that its “Statutory Load Obligation” is defined as Western’s “obligation under Federal law to deliver the power and energy from those hydroelectric projects operated by the Department of the Army and the Bureau of Reclamation to loads served pursuant to Federal Statute.” *Id.* at 1-2.

<sup>4</sup> *Id.* at 3.

<sup>5</sup> Section 1232(a) of EPAAct 2005 defines a “Transmission Organization” as “a Regional Transmission Organization, Independent System Operator, independent transmission provider, or other transmission organization finally approved by [FERC] for the operation of transmission facilities.” 42 U.S.C. § 16431(a)(4) (referring to definition contained in 16 U.S.C. § 796).

<sup>6</sup> *Id.* § 16431(c).

<sup>7</sup> *Id.* § 16431(d).

Western states that “[t]he overarching basis for the FSE requirement stems from Section 1232.”<sup>8</sup> While section 1232 of EPAct 2005 does not expressly exempt federal power marketing agencies like Western from market and transmission expansion-related charges established under an RTO tariff, the requirements that any agreement to transfer control and use of facilities must ensure “consistency with existing contracts”<sup>9</sup> and “consistency with the statutory authorities, obligations, and limitations of the Federal utility”<sup>10</sup> support Western’s interpretation that it must consider and continue to comply with its other pre-existing contractual and statutory obligations when arranging to join an RTO.

Western points to section 9(c) of the Reclamation Project Act of 1939, 43 U.S.C. § 485h(c), and section 5 of the Flood Control Act of 1944, 16 U.S.C. § 825(s), which Western states “are the primary basis for the following requirements that Western must abide by”:

1) Preference in power sales shall be given to public agencies, cooperatives, municipalities, and other non-profit entities; 2) Power disposal shall be for the benefit of domestic and rural consumers; 3) Power shall be sold at the lowest possible rates consistent with sound business principles; 4) Power disposal shall encourage widespread use and prevent monopolization; and 5) construction of transmission lines and related facilities is only authorized to the extent they are necessary to make the power generated at the Federal projects available for sale.<sup>11</sup>

Western also states that, “[p]ursuant to these statutory principles, Western [has] constructed sufficient transmission facilities or purchased transmission capacity . . . to enable it to enter into long-term contractual commitments for the delivery of its finite Federal generation to its statutory load customers,” and “as such its Statutory Load Obligations will not grow.”<sup>12</sup> Therefore, Western concludes, “it has no need for an increase in regional transmission capacity to assist in meeting future delivery needs and cannot agree to subject itself to those additional charges.”<sup>13</sup>

Section 9(c) of the Reclamation Project Act of 1939 establishes a “preference [for] municipalities and other public corporations or agencies . . . co-operatives and other nonprofit organizations financed in whole or in part by loans made pursuant to the Rural Electrification

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<sup>8</sup> Western Letter at 2.

<sup>9</sup> 42 U.S.C. § 16431(c)(1)(B).

<sup>10</sup> *Id.* § 16431(c)(1)(C).

<sup>11</sup> Western Letter at 2. Western notes that section 302 of the Department of Energy Organization Act of 1977, 42 U.S.C. § 7152, created the U.S. Department of Energy, of which it is a part, and transferred certain functions under these statutes to Western from the Department of the Interior and Bureau of Reclamation.

<sup>12</sup> Western Letter at 3.

<sup>13</sup> *Id.*

Act of 1936,”<sup>14</sup> while Section 5 of the Flood Control Act of 1944 requires Western to “transmit and dispose of [electric power and energy generated at reservoir projects] in such manner as to encourage the most widespread use thereof *at the lowest possible rates* to consumers consistent with sound business principles.”<sup>15</sup> Section 5 authorizes Western, “from funds to be appropriated by the Congress, to construct or acquire, by purchase or other agreement, *only* such transmission lines and related facilities as may be necessary in order to make the power and energy generated at said projects available in wholesale quantities for sale on fair and reasonable terms and conditions to facilities owned by the Federal Government, public bodies, cooperatives, and privately owned companies.”<sup>16</sup>

When read together, these statutes appear to support Western’s interpretation of its governing authorities that it must obtain the FSE as a prerequisite to participation in SPP. While these statutes do not expressly bar Western from paying market and transmission expansion-related costs, the language of the statutes supports the proposition that Western must supply its power and energy to its customers in a manner that produces the “lowest possible rates” to consumers. Thus, Western states that this requires an exemption from congestion and losses charges and any Schedule 11 regional transmission charges if it is to join SPP. Further, because Western may construct transmission facilities only as necessary to serve its customers, inferentially Congress did not authorize Western to pay others (such as SPP and its other transmission owners) to construct transmission facilities.

EPAct 2005 envisions Western’s participation in a RTO like SPP, but only in a manner that ensures consistency with Western’s existing statutory requirements and contractual arrangements. The Reclamation Act of 1939 and the Flood Control Act of 1944 make clear that Congress intended that Western market federal power to preference customers “at the lowest possible rates” and acquire transmission only as necessary to serve its preference customers. These requirements lend support for Western’s position that it may not be permitted to participate in regional allocation of transmission expansion costs beyond those necessary to serve its federal preference customers, which Western states are already fully served by its delivery of federal preference power over its existing transmission facilities. Likewise, these requirements support Western’s position that its deliveries to federal preference customers cannot be subject to market-related charges such as congestion and losses, if the imposition of such charges would increase rates from the levels in effect without RTO membership.

The statutes themselves, of course, do not directly address the particular rate issues in question. And, Western’s payment of SPP’s normal transmission charges would not subject Western to excessive charges, because the FERC has found that those charges are just and reasonable. But, to the extent that the SPP Tariff charges would lead to rates to Western consumers that are higher than what would be in effect without RTO membership, or would

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<sup>14</sup> 43 U.S.C. § 485h(c)(1).

<sup>15</sup> 16 U.S.C. § 825s (emphasis added).

<sup>16</sup> *Id.* (emphasis added).

require payments for transmission investments that Western does not require to serve its customers, the statutes are susceptible to an interpretation that requires Western either to refrain from joining the RTO or obtain an appropriate exemption from the charges. It also is reasonable to defer to Western's understanding of its obligations. *See Chevron U.S.A. Inc. v. Natural Resources Defense Counsel, Inc.*, 467 U.S. 837, 843-44 (1984) (when a statute is silent or ambiguous or Congress has not directly addressed the precise question at issue, a court evaluates "whether the agency's answer is based on a permissible construction of the statute;" a "court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction;" if Congress left a "gap" in the statute, a court should defer to the reasonable interpretation of the agency). Congress did not speak directly to the precise question. While one could reach a different interpretation of the relevant statutes that allowed Western to pay any RTO transmission charges that the FERC had found to be just and reasonable, Western's interpretation of its governing statutes is a permissible construction of the statutes and one to which the FERC, like a court, can defer.

It also is likely that the FERC would find the FSE to be a just and reasonable accommodation to enable Western to participate in SPP. FERC has long encouraged public power participation in RTOs and has accepted special provisions to address the unique circumstances surrounding public entities' participation in RTOs.<sup>17</sup> The accommodations Western seeks through the FSE, as they are limited to Western's delivery of power from U.S. government facilities to statutory preference customers over Western's transmission facilities, appear to be limited to what is necessary to address Western's unique challenges to RTO participation.

Further, the FERC has previously granted similar carve-outs from RTO charges for other entities, such as parties to pre-existing, grandfathered agreements ("GFAs") in the SPP Integrated Marketplace and other RTO markets.<sup>18</sup> FERC likely will find a similar

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<sup>17</sup> *See, e.g., Sw. Power Pool, Inc.*, 125 FERC ¶ 61,239, at P 15 (2008) ("We continue to believe that the successful development of regional transmission organizations must include public power, and we believe that the Nebraska Entities' participation will enhance the reliability and economic benefits of SPP."); *TRANSLink Transmission Co., L.L.C.*, 101 FERC ¶ 61,140, at P 26 (2002) ("We believe that successful RTO development must include public power and we are heartened by the fact that the TRANSLink proposal has attracted so much interest by public power participants. . . . In Order No. 2000, we recognized that a properly formed RTO should include all transmission owners in a region and further acknowledged that public power entities faced unique difficulties in RTO participation. Therefore, we indicated that we would be flexible and analyze proposals to include public power on a case-by-case basis."); *Regional Transmission Organizations*, Order No. 2000, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,089, at 31,200-201 (1999) ("We reaffirm our preliminary determination that a properly formed RTO should include all transmission owners in a specific region, including . . . Federal Power Marketing Agencies (PMAs) . . . . We acknowledge that public power entities face several difficult issues regarding RTO participation . . . on an RTO-by-RTO basis, we will examine submitted proposals that provide public power and cooperatives with the flexibility to join an RTO."), *order on reh'g*, Order No. 2000-A, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000), *aff'd sub nom. Pub. Util. Dist. No. 1 v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

<sup>18</sup> *See, e.g., Sw. Power Pool, Inc.*, 144 FERC ¶ 61,254, at PP 18, 23 (2013) (conditionally approving settlement filed by SPP to implement a "carve-out" for certain GFAs from the SPP Integrated  
(continued . . .)

accommodation for Western (i.e., the FSE) to be just and reasonable to enable Western's participation in SPP.

In short, while Western's authorizing statutes do not expressly state that Western must be exempt from RTO transmission expansion, congestion, and losses charges, Western's interpretation of its governing statutes to require the FSE appears reasonable and would likely be approved by the FERC and upheld by any reviewing court.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry S. Spector". The signature is fluid and cursive, with the first name "Barry" being more prominent and the last name "Spector" written in a more compact, stylized manner.

Barry S. Spector

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(... continued)

Marketplace); *see also, e.g., Sw. Power Pool, Inc.*, 144 FERC ¶ 61,255, at PP 1, 19 (2013) (conditionally accepting revisions to the SPP Tariff to implement a GFA carve out subject to additional Tariff revisions).