

**GAO**

Report to the Chairman, Subcommittee  
on Water and Power, Committee on  
Resources, House of Representatives

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April 2000

# FEDERAL POWER

## The Evolution of Preference in Marketing Federal Power



Accountability \* Integrity \* Reliability



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## Abbreviations

BPA	Bonneville Power Administration
DOE	Department of Energy
FERC	Federal Energy Regulatory Commission
PMA	power marketing administration
SEPA	Southeastern Power Administration
SWPA	Southwestern Power Administration
TVA	Tennessee Valley Authority
WAPA	Western Area Power Administration

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United States General Accounting Office  
Washington, D.C. 20548

Resources, Community, and  
Economic Development Division

B-284383

April 21, 2000

The Honorable John T. Doolittle  
Chairman, Subcommittee on  
Water and Power  
Committee on Resources  
House of Representatives

Dear Mr. Chairman:

For decades, the power marketing administrations (PMA)<sup>1</sup> of the Department of Energy (DOE) have provided electricity, generated largely at federal multipurpose water projects, to customers in over 30 states. To guide the PMAs' efforts in marketing electricity, the Congress and the courts have directed the PMAs to give certain customers preference. Generally, preference is the opportunity to obtain priority access to federal power that has traditionally been sold at rates generally below those of other sources. Preference provisions come into play only when a potential customer that does not have preference (such as an industrial user or a commercial power company) and a preference customer (such as a municipally owned utility or a rural electric cooperative) want to buy federal power and not enough is available for both. As we enter the next millenium, the electricity industry is restructuring from one dominated by regulated monopolistic electric utilities to one that increasingly allows customers to choose their source of electricity. The Congress is now considering legislation dealing with this industry's restructuring, including the role of preference in the PMAs' sale of electricity.

To help in congressional deliberations on the future role of the PMAs and their preference customers, you asked us to (1) identify how federal legislation and major relevant court cases have, over time, directed the PMAs to give preference to particular customers in purchasing electricity and (2) discuss the role of preference in the PMAs' electricity sales in light of the restructuring of the electricity industry.

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<sup>1</sup>The PMAs are the Bonneville Power Administration (Bonneville), which serves the Pacific Northwest; Southeastern Power Administration; Southwestern Power Administration; and Western Area Power Administration (Western).

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To do this, we reviewed power-marketing and land reclamation statutes that contain provisions providing such preferences, which are referred to as preference clauses or provisions. We also reviewed numerous legislative proposals, as well as numerous judicial and administrative cases, that have interpreted and applied the portions of various statutes that confer preference. A list of the statutes, court cases, and administrative rulings we reviewed appears in appendix I. A table showing the extent to which the PMAs are selectively affected by various preference-related statutes is contained in appendix II.

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## Results in Brief

For nearly a century, the Congress has enacted numerous statutes that designate types of customers (such as public bodies and cooperatives) and/or geographic areas for preference and priority in purchasing electricity from federal agencies. In general, the purpose of providing preference has been to (1) direct the benefits of public resources—relatively inexpensive hydropower—to the public through nonprofit entities, (2) spread the benefits of federally generated hydropower widely and encourage the development of rural areas, (3) prevent private interests from gaining control of the development of electric power on public lands, and (4) provide a yardstick against which the rates of privately owned utilities can be measured. The PMAs' specific applications of various preference provisions have been challenged on a number of occasions in the courts. In some instances, the courts have directed a PMA to provide power to preference customers, and in other instances, they have supported the denial of power to such customers.

The characteristics of the electricity industry have changed and continue to change, both regionally and nationally. Over the last 20 years, competition has been replacing regulation in major sectors of the U.S. economy, and new legislation and technological changes have created a climate for change in traditional electricity markets. In this context, the Congress is now considering a number of proposals to restructure the electricity industry, including some that would encourage the states to allow retail customers a choice in selecting their electricity supplier. As these proposals are discussed, the Congress is considering such issues as competition in pricing, the balance of equity among all stakeholders, and the role of preference in the PMAs' sale of electricity.

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## Preference Clauses and Beneficiaries Have Evolved Over Time

Preference clauses have existed throughout the history of federal power legislation and have been directed to a variety of customers and regions of the nation. The Congress has mandated preference in the sale of electricity by federal agencies in a number of power-marketing and land reclamation statutes. The idea of establishing public priority or preference in the use of public water resources dates back to the 1800s, when the Congress decided to keep navigable inland waterways free from state taxes, duties, and the construction of private dams. The Reclamation Act of 1906, which is also referred to as the Town Sites and Power Development Act of 1906, is generally considered the federal government's entry into the electric power field. The act grants preference in the disposition of surplus<sup>2</sup> hydroelectric power from federal irrigation projects for "municipal purposes," such as street lighting.

As the availability and sources of electricity have changed over time, the types of preference clauses the Congress has included in legislation have evolved. For example, with the Federal Power Act of 1920, preference began to evolve from serving "municipal purposes" to serving particular classes of users,<sup>3</sup> such as public bodies<sup>4</sup> and cooperatives.<sup>5</sup> The 1920 act required the federal government, when faced with breaking a tie between competing equal applications, to give preference to states and municipalities in awarding licenses for hydroelectric plants owned and operated by nonfederal entities. The act defined a municipality as a city, county, irrigation district, drainage district, or other political subdivision or agency of a state competent under law to develop, transmit, utilize, or distribute power. One primary benefit of giving priority to public utilities and cooperatives, which distribute power directly to customers without

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<sup>2</sup>Surplus power is power in excess of a project's operational requirements (e.g., pumping water to fields being irrigated). The generation of electricity was seen as a means of making the hydroelectric projects self-supporting and financially solvent and as a useful complement to the projects' other purposes, which may include flood control, irrigation, navigation, or recreation.

<sup>3</sup>The Act of September 18, 1922, continued to give preference to municipal purposes for surplus power from the Salt River Project in Arizona.

<sup>4</sup>"Public bodies" are defined differently in various statutes and include entities such as municipally owned electric utilities, irrigation districts, public utility districts, and state agencies. Bonneville and Western also consider Native American tribes to be public bodies.

<sup>5</sup>A cooperative is a nonprofit enterprise or organization owned by and operated for the benefit of those using its services.

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making a profit, is lower electricity rates for consumers. The Congress has also provided preference to specified regions of the nation.

The notion of providing public bodies and cooperatives with preference for federal hydropower rests on the general philosophy that public resources belong to the nation and their benefits should be distributed directly to the public whenever possible. Under the various preference clauses, preference customers are given priority over nonpreference customers in the purchase of power. In many cases, the preference provisions of federal statutes give the electric cooperatives, many of which are rural, and public bodies priority in seeking to purchase federally produced and federally marketed power. However, the courts have held that preference customers do not have to be treated equally and that all potential preference customers do not have to receive an allotment of federal power. Preference provisions come into play only when a potential customer that does not have preference (such as an industrial user or a commercial power company) and a preference customer (such as a municipally owned utility or a rural electric cooperative) want to buy federal power and not enough is available for both.

The Congress initially granted preference in the sale of federal electricity to public bodies and cooperatives for several reasons. First, it was a way to ensure that the benefits of this power were passed on to the public at the lowest possible cost, using cost-based rates, because the preference customers generally were entities that would not incorporate a profit in their rates. Second, it was also meant to extend the benefits of electricity to remote areas of the nation using publicly and cooperatively owned power systems. Additionally, the Congress gave preference to public bodies and cooperatives to prevent the monopolization of federal power by private interests. The rates charged by such nonprofit entities could then serve as a yardstick for comparison with the rates charged by public and private utilities.<sup>6</sup> For example, the Boulder Canyon Project Act of 1928 encouraged public nonprofit distributors to begin marketing power by allowing them a reasonable amount of time to secure financing in order to construct generation and transmission facilities. According to the House Committee on Irrigation and Reclamation, one of the committees that drafted the 1928 act, the allocation of power rights between the preference and nonpreference customers was expected to create competition among

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<sup>6</sup>See GAO's comments on the Pacific Northwest Electric Power and Planning Conservation Act (EMD-79-4, Oct. 26, 1978).

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various entities, ensuring reasonable rates and good service. These entities included states, political subdivisions, municipalities, domestic water-supply districts, and private companies. The committee viewed the preference clause as a bulwark against the monopolization of power by private companies. Another, more recent embodiment of the premise that public resources should be provided to the public without an effort to profit from their sale is the Hoover Power Plant Act of 1984. This act gives preference primarily to municipalities and others for power generated at the Hoover Dam. It also authorizes the renewal of a preference power contract with an investor-owned utility, originally entered under the Boulder Canyon Project Act of 1928.

At about the same time as the Congress was enacting the Rural Electrification Act of 1936 to encourage cooperatives and others to extend their electric systems into nearby rural areas, it enacted other statutes that affect how federally generated electricity is sold, especially to cooperatives. The Bonneville Project Act of 1937, along with the earlier (1933) Tennessee Valley Authority (TVA) Act, extended preference to include nonprofit cooperative organizations. The acts also authorized the construction of federal transmission lines to carry the power, thus minimizing regional reliance on private power companies. The two laws established a statutory framework of energy allocation policies in an era of extensive federal hydroelectric development. The 1937 act authorized the construction of federal power lines in order to transmit the federal power as widely as practicable. The act states that preference was provided to public bodies and cooperatives to ensure that the hydropower projects were operated for the benefit of the general public, particularly domestic (residential) and rural customers. The preference clauses in the Bonneville and TVA<sup>7</sup> acts were both viewed as yardsticks for evaluating the rates charged by private utilities.

Preference for public entities and cooperatives is also found in the Reclamation Project Act of 1939 and the Flood Control Act of 1944. The Reclamation Project Act of 1939, which provides guidance for projects operated by the Bureau of Reclamation, gives preference to municipalities, other public corporations or agencies, and cooperatives and other nonprofit organizations. The Bureau is an agency within the Department of

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<sup>7</sup>Although not a PMA, TVA is an independent multipurpose federal corporation that, among other activities, generates and markets electricity to customers in nearly all of Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia.

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the Interior that generates much of the electricity sold by Bonneville and Western. The 1939 act limited preference for cooperatives to those financed at least in part by loans made under the Rural Electrification Act of 1936, as amended. The Flood Control Act of 1944, which gives guidance for projects operated by the U.S. Army Corps of Engineers, gives preference to public bodies and cooperatives. The Corps generates electricity sold by all four PMAs. The act requires that electricity be sold to encourage the most widespread use of power at the lowest rates to consumers consistent with sound business practices. The federal government was authorized to construct or acquire transmission lines and related facilities to supply electricity to federal facilities, public bodies, cooperatives, and privately owned companies. The legislative history indicates that priority was given to public bodies and cooperatives to expand rural electrification and to avoid monopolistic exploitation by private utilities.

Subsequent statutes, while building on preference provisions provided by other federal power marketing laws, granted regional preference. The Pacific Northwest Power Preference Act, enacted in 1964, authorizes Bonneville to sell surplus federal hydropower outside the Pacific Northwest if there is no current market for the power at the rate established for its disposition in this region. The 1980 Northwest Power Act requires Bonneville to provide power to meet all the contracted-for needs of its customers in the Northwest, extending the regional preference provisions of the 1964 act to include not only hydropower but also power from Bonneville's other sources—primarily nuclear power. As a result of this regional preference, Bonneville's customers in the Pacific Northwest—including private utility and direct service customers as well as public utilities—have priority over preference customers in the Pacific Southwest. The act also requires Bonneville to generally charge lower rates to preference customers than to nonpreference customers.

The Congress also granted regional preference in the sale of electricity from federal projects to other parts of the country, such as the Northeast, that are not served by the PMAs or TVA. The 1957 Niagara Redevelopment Act establishes (1) a division of all power from the project into preference and nonpreference power, (2) a preference for public bodies and cooperatives, with an emphasis on serving domestic and rural consumers, and (3) a geographic preference for preference customers in New York and in neighboring states.

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Other statutes give geographic preference to entire states or portions of states for purchases of electricity generated in those areas. For example, the 1928 Boulder Canyon Project Act gives preference to customers in Arizona, California, and Nevada for purchases of excess power from the Boulder Canyon Project. This preference language distinguishes among preference customers, giving the states (e.g., California) a priority over municipalities (e.g., Los Angeles).

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### Application of Preference Provisions Reviewed by the Courts

Although we found no instances in which the statutory preference provisions themselves were challenged, specific applications of these provisions by the PMAs have been challenged in the courts and in administrative proceedings. The cases have included disputes among preference customers and between preference and nonpreference customers of the various PMAs. In some instances, the courts have directed a PMA to provide power to preference customers, and in other instances, they have supported a PMA's denial of power to such customers. General principles that may be drawn from the various court interpretations and rulings are that (1) PMAs must act in favor of customers specifically provided preference and priority in purchasing surplus power when nonpreference customers are competing for this power, (2) PMAs have discretion in deciding how and to which preference customers they will distribute electricity when the customers are in competition with each other for limited power, and (3) preference customers do not have to be treated equally, nor do individual preference customers have an entitlement to all or any of the power. The Federal Energy Regulatory Commission has affirmed the application of preference clauses in its rulings, as has the Attorney General in an opinion interpreting the preference provision of the 1944 Flood Control Act. A list of the court cases and administrative rulings we reviewed, with a brief description of each, is included in appendix I.

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### Reassessment of Preference in PMA Electricity Sales Is an Issue in Electricity Industry Restructuring

The characteristics of the electricity industry on a national and regional basis have changed over time and continue to change. For example, the issues and problems of the 1930s, when rural America was largely without electricity and private utilities were not extensively regulated, were not those that confronted the Congress in later decades or that confront the Congress now.

Over the last 20 years, competition has been replacing regulation in major sectors of the U.S. economy. New legislation at the federal and state levels and technological changes have created a climate for change in traditional

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electricity markets. For example, the Congress is considering a number of proposals to restructure the electricity industry, including some that would encourage the states to allow retail customers a choice in selecting their electricity supplier. At the retail level, the administration estimates that competition will result in annual savings of \$20 billion for consumers and nearly \$2 billion for the government. As of April 2000, 24 states and the District of Columbia have issued comprehensive deregulation orders or enacted restructuring legislation. The extent to which the federal government should participate in fostering retail competition has yet to be decided.

In a March 1998 report,<sup>8</sup> we noted that the Congress has options that, if adopted, would affect preference customers. Considering changes to the preference provisions would be consistent with the spirit of our testimonies in February and March 2000<sup>9</sup> before the Senate and House Budget Committees and the Senate Committee on Governmental Affairs. At these hearings, we discussed the need to reexamine many federal programs in light of changing conditions and to redefine the beneficiaries of these programs, if necessary.

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## Agency Comments

We provided DOE with copies of a draft of this report. We received comments from DOE's Bonneville Power Administration and DOE's Power Marketing Liaison Office, which is responsible for the other three PMAs. Their comments are included in appendixes III and IV, respectively.

The PMAs generally agreed with the information in our draft report, and provided several technical and editorial comments, which we incorporated as appropriate. They also stated that they have continually evaluated their roles and policies in light of changes occurring in the electric utility industry. They agreed with us that the Congress has the latitude to reconsider all laws containing both customer and geographic preference in federal electricity sales. They also observed that the current administration

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<sup>8</sup>*Federal Power: Options for Selected Power Marketing Administrations' Role in a Changing Electricity Industry* (GAO/RCED-98-43, Mar. 6, 1998).

<sup>9</sup>*Budget Issues: Effective Oversight and Budget Discipline Are Essential—Even in a Time of Surplus* (GAO/T-AIMD-00-73, Feb. 1, 2000), *Congressional Oversight: Opportunities to Address Risks, Reduce Costs, and Improve Performance* (GAO/T-AIMD-00-96, Feb. 17, 2000), and *Managing in the New Millenium: Shaping a More Efficient and Effective Government for the 21st Century* (GAO/T-OCG-00-9, Mar. 29, 2000).

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does not support the repeal of the “preference clause” as part of the restructuring of the electricity industry and did not incorporate such provisions in its bill to restructure the industry. We note, however, that several other bills the Congress is considering could affect the way that federal agencies sell power to preference customers.

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To examine the evolution of preference in the PMAs’ marketing, we reviewed statutes and federal court cases, rulings by the Federal Energy Regulatory Commission, and an Attorney General’s opinion on federally mandated preference in electricity licensing or sales by federal facilities. As requested, we performed detailed reviews of legislative histories for nine of these statutes. We also reviewed past GAO reports, testimonies, and other products that relate to preference in the PMAs’ electricity sales. We interviewed the staffs of the PMA liaison offices in Washington, D.C., as well as the General Counsels of each of the four PMAs. We reviewed various other preference-related documents, including relevant law review articles, issue briefs from trade associations, and the PMAs’ marketing plans.

We performed our review from October 1999 through April 2000 in accordance with generally accepted government auditing standards.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to appropriate House and Senate Committees and Subcommittees; interested Members of the Congress; Judith A. Johansen, Administrator and Chief Executive Officer, Bonneville Power Administration; Charles A. Borhardt, Administrator, Southeastern Power Administration; Michael A. Deihl, Administrator, Southwestern Power Administration; and Michael S. Hacskeylo, Administrator, Western Area Power Administration. We will also make copies available to others on request.

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If you or your staff have any questions or need additional information, please contact me or Derek Stewart at (202) 512-3841. Key contributors to this report were Charles Hessler, Martha Vawter, Peg Reese, Doreen Feldman, and Susan Irwin.

Sincerely yours,

A handwritten signature in black ink that reads "Jim Wells". The signature is written in a cursive style with a large, sweeping initial "J".

Jim Wells  
Director, Energy, Resources  
and Science Issues

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# Compendium of Selected Statutes, Court Cases, and Administrative Rulings Relating to Preference

Statutes	Relevant provisions
Act of March 3, 1877 (Desert Land Act) [19 Stat. 377, 43 U.S.C. 321]	Grants preference to certain classes of public users to surplus reclamation water from public lands.
Act of April 16, 1906 (Reclamation Act of 1906 or Town Sites and Power Development Act of 1906) [34 Stat. 116, 117, 43 U.S.C. 522]	Establishes the first precedent for a municipality's preference to surplus hydropower generated at federal irrigation projects. Provides for the disposition of hydroelectric power from irrigation projects and requires the Secretary of the Interior to give a preference to power sales for municipal purposes.
Act of December 19, 1913 (Raker Act) [38 Stat. 242, 245]	Provides the city and county of San Francisco with a right-of-way over public lands for the construction of aqueducts, tunnels, and canals for a waterway, power plants, and power lines for the use of San Francisco and other municipalities and water districts. Prohibits grantees of the right to develop and sell water and electric power from selling or leasing those rights to any corporation or individual other than another municipality, municipal water district, or irrigation district.
Federal Water Power Act (1920) (Federal Power Act) [41 Stat. 1063, 1067, 16 U.S.C. 791a, 800]	Requires FERC (formerly the Federal Power Commission) to give preference to states and municipalities in issuing licenses for hydropower projects operated by nonfederal entities, if the competing applications are equally well adapted for water development. (Preference criteria in this act may be used in disposing of power to preference customers under the Boulder Canyon Act of 1928.)
Act of September 18, 1922 [42 Stat. 847, 43 U.S.C. 598]	Gives preference to municipal purposes for surplus power from the Salt River Project in Arizona.
Act of December 21, 1928 (Boulder Canyon Project Act) [45 Stat. 1057, 1060, 43 U.S.C. 617, 617d]	Requires the Secretary of the Interior to give preference within the policy of the Federal Water Power Act, i.e., to states and municipalities when selling power from the project. Gives the states of Arizona, California, and Nevada initial priority over other preference customers.
Tennessee Valley Authority Act of 1933, as amended [48 Stat. 58, 64; 49 Stat. 1075, 1076, 16 U.S.C. 831, 831i]	Requires TVA to give preference in power sales to states, counties, municipalities, and cooperative organizations of citizens or farmers that are organized or doing business not for profit but primarily for the purpose of supplying electricity to their own citizens or members. Authorizes TVA to construct its own transmission lines to serve farms and small villages not otherwise supplied with reasonably priced electricity and to acquire existing electric facilities used to provide power directly to these customers.
Rural Electrification Act of 1936 [49 Stat. 1363, 1365, 7 U.S.C. 901, 904]	Authorizes loans for rural electrification and grants preferences to states; municipalities; utility districts; and cooperative, nonprofit, or limited-dividend associations.
Bonneville Project Act of 1937 [50 Stat. 731, 733, 16 U.S.C. 832, 832b]	Requires BPA to give preference and priority to public bodies (nonfederal government agencies) and cooperatives. Allows the people within economic transmission distance of the Bonneville project (Washington, Oregon, Idaho, and Montana) a reasonable amount of time to create public or cooperative agencies so as to qualify for the public power preference and secure financing.
Act of May 18, 1938 (Fort Peck Project Act) [52 Stat. 403, 405, 16 U.S.C. 833, 833c]	Requires the Bureau of Reclamation to give preference and priority to public bodies and cooperatives.
Reclamation Project Act of 1939 [53 Stat. 1187, 1194, 43 U.S.C. 485, 485h(c)]	Requires the government, when selling surplus power from its reclamation projects, to give preference to municipalities and other government agencies, and to cooperatives and other nonprofit organizations financed in whole or in part by loans from the Rural Electrification Administration.

Continued

**Appendix I  
Compendium of Selected Statutes, Court  
Cases, and Administrative Rulings Relating  
to Preference**

Statutes	Relevant provisions
Act of October 14, 1940 (Water Conservation and Utilization Act) [54 Stat. 1119, 1120 and 1124, 16 U.S.C. 590y, 590z-7]	Authorizes water projects in the Great Plains and arid and semiarid areas of the nation. Gives preference in sales or leases of surplus power to municipalities and other public corporations or agencies; and to cooperatives and other nonprofit organizations financed in whole or in part by loans under the Rural Electrification Act of 1936.
Act of June 5, 1944 (Hungry Horse Dam Act) [58 Stat. 270, 43 U.S.C. 593a]	Authorizes the construction of the Hungry Horse Dam in western Montana for uses primarily in the state of Montana. This "Montana Reservation" has been interpreted as a geographic preference requiring a calculated quantity of power (221 average megawatts) from Hungry Horse Dam to be offered first for sale in Montana to preference and nonpreference customers before the calculated amount of power is offered to other BPA customers, including preference customers in other states.
Act of December 22, 1944 (Flood Control Act of 1944) [58 Stat. 887, 890, 16 U.S.C. 825s]	Gives preference to public bodies and cooperatives for power generated at Corps of Engineers projects and authorizes transmission to federal facilities and those owned by public entities, cooperatives, and private companies.
Act of March 2, 1945 (Rivers and Harbors Act of 1945) [59 Stat. 1021, 1022]	Provides for the distribution of power from the Snake River Dams and the Umatilla Dam in accordance with the preference provisions of the Bonneville Project Act.
Act of July 31, 1950 (Eklutna Act) [64 Stat. 382, 383 (repealed, Pub. L. 104-58)]	Gave preference to public bodies and cooperatives and to federal agencies in sales of power from the Eklutna project near Anchorage, Alaska.
Act of September 30, 1950 [64 Stat. 1083]	Provides for the sale or lease of power from the Palisades Dam in southeastern Idaho to bodies entitled to preference under federal reclamation laws.
Act of June 18, 1954 [68 Stat. 255, 256]	Requires the Secretary of the Interior to give preference in the sale of power generated at the Falcon Dam on the Texas/Mexico border to public bodies and cooperatives.
Act of July 27, 1954 [68 Stat. 573]	Authorizes BPA to purchase power generated at the Priest Rapids Dam in Washington. Requires BPA to sell the power according to the preference provisions applicable to other sales of BPA power.
Atomic Energy Act of 1954 [68 Stat. 919, 929, 42 U.S.C. 2064]	Provides for preference to public bodies and cooperatives in the sale of power from the Department of Energy's nuclear production facilities; also provides preference to private utilities serving high-cost areas not serviced by public bodies and cooperatives.
Act of August 12, 1955 (Trinity River Division Act) [69 Stat. 719, 720]	Reserves 25 percent of the power from the Trinity power plants for preference customers in Trinity County, California.
Act of April 11, 1956 (Colorado River Storage Project Act) [70 Stat. 105, 107]	Provides for the sale of power from the Colorado River Storage Project and participating projects to bodies entitled to preference under reclamation laws.
Niagara Redevelopment Act (1957) [Pub. L. 85-159, 71 Stat. 401, 16 U.S.C. 836]	Sets out preference and allocation provisions required to be included in FERC's license to the state of New York for the sale of power generated from the Niagara River. Contains several allocation mechanisms: (1) a division of all project power into preference and nonpreference power, (2) a preference clause for public bodies and cooperatives, particularly for the benefit of domestic and rural customers, (3) a provision that preference power sold initially to private utilities is subject to withdrawal to meet the needs of preference customers, (4) a geographic preference (80 percent of the preference power is reserved for New York preference customers and up to 20 percent for neighboring states), and (5) an allocation of a specific amount of power to an individual nonpreference customer for resale to specific industries.

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**Appendix I  
Compendium of Selected Statutes, Court  
Cases, and Administrative Rulings Relating  
to Preference**

Statutes	Relevant provisions
Flood Control Act of 1958 [Pub. L. 85-500, tit. II, 72 Stat. 305, 311]	Provides that a reasonable amount of power, up to 50 percent, from dams subsequently constructed by the Corps of Engineers on the Missouri River, shall be reserved for preference customers within the state in which each dam is located.
Atomic Energy Commission Authorization Act (1962) [Pub. L. 87-701, 76 Stat. 599, 604]	Authorizes the sale of by-product energy from the Hanford New Production Reactor to purchasers agreeing to offer 50 percent of the electricity generated to private organizations and 50 percent to public organizations. (The Department of Energy has terminated the operation of this reactor.)
Flood Control Act of 1962 [Pub. L. 87-874, tit. II, 76 Stat. 1180, 1191-1192 and 1193-1194 (section 204, relating to the Snettisham project, repealed, Pub. L. 104-58)]	Requires "first preference" for customers in Tuolumne and Calaveras Counties in California for 25 percent of the additional power generated by the New Melones project. Required preference for federal agencies, public bodies, and cooperatives in power sales from the Snettisham project near Juneau, Alaska.
Act of December 23, 1963 [Pub. L. 88-237, 77 Stat. 475]	Requires the Secretary of the Interior to give preference in the sale of power generated at Amistad Dam on the Texas/Mexico border to federal facilities, public bodies, cooperatives, and privately owned companies.
Act of August 31, 1964 (Pacific Northwest Power Preference Act) [Pub. L. 88-552, 78 Stat. 756, 758, 16 U.S.C. 837, 837a, 837b, 837d, and 837h]	Authorizes the sale outside the Pacific Northwest of federal hydroelectric power for which there is no current market in the region or that cannot be conserved for use in the region. Provides that sales outside the Pacific Northwest are subject to termination of power deliveries if a BPA customer in the Pacific Northwest needs the power. Grants reciprocal protection with respect to energy generated at, and the peaking capacity of, federal hydroelectric plants in the Pacific Southwest, or any other marketing area, for use in the Pacific Northwest. Explicitly provides that the Hungry Horse Dam Act's geographical preference for power users in Montana is not modified by this act.
Colorado River Basin Project Act (1968) [Pub. L. 90-537, 82 Stat. 885, 889 and 901, 43 U.S.C. 1501, 1523 and 1554]	Authorizes the purchase of nonfederal thermal power for the Central Arizona irrigation project. Authorizes, subject to the preference provisions of the Reclamation Project Act, the disposal of power purchased, but not yet needed, for the project.
Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act) (1980) [Pub. L. 96-501, 94 Stat. 2697, 2712, 2723, and 2734, 16 U.S.C. 839c, 839e, and 839g]	Explicitly retains the preference provisions of the Bonneville Project Act of 1937 and other federal power marketing laws. Requires BPA to provide power to meet all the contracted-for needs of its customers in the Northwest. As a result of this regional preference, BPA's public as well as private utility and direct service industry customers in the Pacific Northwest have priority over preference customers in the Pacific Southwest. Requires BPA to charge lower rates to preference customers than to nonpreference customers. Also requires BPA to offer initial 20-year power sale contracts to specific nonpreference as well as preference customers throughout the Pacific Northwest: (1) publicly owned utilities, (2) federal agencies, (3) privately owned utilities, and (4) directly served industrial customers.
Hoover Power Plant Act of 1984 [Pub. L. 98-381, 98 Stat. 1333, 1335, 43 U.S.C. 619a]	Gives preference power to municipalities, an investor-owned utility, and others for power generated at the Hoover Power Plant.
Electric Consumers Protection Act of 1986 [Pub. L. 99-495, 100 Stat. 1243]	Amends the Federal Power Act to provide that preference does not apply to relicensing. (Retains preference for original licenses.)
National Defense Authorization Act for Fiscal Year 1994 [Pub. L. 103-160, 107 Stat. 1537, 1935]	For a 10-year period, reserves power that becomes available because of military base closures for sale to preference entities in California that are served by the Central Valley Project and that agree to use such power for economic development on bases closed or selected for closure under the act.

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**Appendix I  
Compendium of Selected Statutes, Court  
Cases, and Administrative Rulings Relating  
to Preference**

<b>Court cases</b>	<b>Relevant provisions</b>
Energy and Water Development Appropriations Act, 1996 [Pub. L. 104-46, 109 Stat. 402, 420]	Authorizes BPA to sell excess power outside the Pacific Northwest on a firm basis for a contract term not to exceed 7 years, if the power is first offered to public bodies, cooperatives, investor-owned utilities, and direct service industrial customers identified in the Northwest Power Act.
<b>Court cases</b>	<b>Relevant decision</b>
<u>Arizona Power Pooling Association v. Morton</u> , 527 F.2d 721, (9th Cir. 1975), <u>cert. denied</u> , 425 U.S. 911 (1976)	The court applied the Reclamation Project Act of 1939's preference clause to governmental sales of thermally generated electric power from the Central Arizona Project. The court held that under the act's preference clause, the Secretary of the Interior must give preference customers an opportunity to purchase excess power before offering it to a private customer. The court also held that preference customers do not have entitlement to federal power.
<u>Arizona Power Authority v. Morton</u> , 549 F.2d 1231 (9th Cir. 1977), <u>cert. denied</u> , 434 U.S. 835 (1977)	The court held that the implementation of geographic preferences in the allocation of federal hydroelectric power under the Colorado River Storage Project Act in a manner that discriminated among preference customers was within the discretion of the Secretary of the Interior and not reviewable by the court.
<u>City of Santa Clara v. Andrus</u> , 572 F.2d 660 (9th Cir.), <u>cert. denied</u> , 439 U.S. 859 (1978)	The court held that the Secretary of the Interior could not sell federally marketed power to a private utility, even on a provisional basis, while denying power to a preference customer. Only if the available supply of power exceeds the demands of interested preference customers may power be sold to private entities. Preference means that preference customers are given priority over nonpreference customers in the purchase of power. However, preference customers do not have to be treated equally, nor do all potential preference customers have to receive an allotment.
<u>City of Anaheim v. Kleppe</u> , 590 F.2d 285 (9th Cir. 1978); <u>City of Anaheim v. Duncan</u> , 658 F.2d 1326 (9th Cir. 1981)	The court held that the preference clause of the Reclamation Project Act of 1939 was not violated by the sale of federal power to private utilities on an interim basis when preference customers lacked transmission capacity to accept such power within a reasonable time and did not offer to buy power when it was originally sold. As a result, there was no competing offer between a preference and a nonpreference customer.
<u>Aluminum Company of America v. Central Lincoln Peoples' Utility District</u> , 467 U.S. 380 (1984), <u>rev'g Central Lincoln Peoples' Utility District v. Johnson</u> , 686 F.2d 708 (9th Cir. 1982)	The Supreme Court held that terms of contracts, which the Pacific Northwest Electric Power Planning and Conservation Act required BPA to offer to certain nonpreference customers, did not conflict with the applicable preference provisions. The preference provisions determine the priority of different customers when there are competing applications for power that can be allocated administratively. Here, however, the contracts in question were not part of an administrative allocation of preference power, and the power covered by the initial contracts was allocated directly by the statute. Since BPA was not authorized to administratively allocate this power, there could be no competing applications for the power, and the preference provisions did not apply to the transactions.
<u>ElectriCities of North Carolina, Inc. v. Southeastern Power Administration</u> , 774 F.2d 1262 (4th Cir. 1985)	A challenge to SEPA's 1981 allocation policy for the Georgia-Alabama power system, changing the location and list of preference customers, was denied. The court held that the allocation of preference power is discretionary and that the preference provision of the Flood Control Act is too vague to provide a standard for the court to apply to SEPA's actions.
<u>Greenwood Utilities Commission v. Hodel</u> , 764 F.2d 1459 (11th Cir. 1985), <u>aff'g Greenwood Utilities Commission v. Schlesinger</u> , 515 F. Supp. 653 (M.D. Ga. 1981)	A challenge to sales of capacity without energy to investor-owned utilities was denied. The court held that the Flood Control Act's preference provision did not establish an entitlement to power or standards for eligibility for power. The statute is too vague to permit judicial review of sales and allocations decisions.

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**Appendix I  
Compendium of Selected Statutes, Court  
Cases, and Administrative Rulings Relating  
to Preference**

<b>Court cases</b>	<b>Relevant decision</b>
<u>Arvin-Edison Water Storage District v. Hodel</u> , 610 F. Supp. 1206 (D. D.C. 1985)	Irrigation districts' claim to an allocation of power ahead of other preference customers (super preference) for WAPA power was denied. The preference clause of the Reclamation Project Act does not provide a super preference for irrigators; it only provides that public entities be given preference over private entities. The clause does not require that all preference customers be treated equally or that they even receive an allocation. The allocation decision is within an agency's discretion and cannot be reviewed by the court.
<u>Brazos Electric Power Cooperative, Inc. v. Southwestern Power Administration</u> , 828 F.2d 1083 (5th Cir. 1987)	The court upheld the dismissal of a challenge by an electric cooperative to an exchange arrangement between a SWPA customer and an investor-owned utility. The investor-owned utility's arrangement with preference customers does not violate the preference provision of the Flood Control Act. Even though the investor-owned utility receives some economic benefits, this is not a sham sale of preference power.
<u>ElectriCities of North Carolina, Inc. v. Southeastern Power Administration</u> , 621 F. Supp. 358 (W.D.N.C. 1985)	SEPA's decision to create two divisions and sell some power to nonpreference customers in its Western Division while excluding preference customers in its Eastern Division is not subject to challenge by those excluded, who have no right or entitlement to allocations of SEPA power.
<u>Salt Lake City v. Western Area Power Administration</u> , 926 F.2d 974 (10th Cir. 1991)	The court held that WAPA reasonably interpreted the preference provisions of the Reclamation Project Act of 1939 in determining that preference applied only to municipalities that operated their own utility systems, and not to every city or town that fit the act's definition of "municipality."
<b>Administrative rulings</b>	<b>Relevant decision</b>
<u>Municipal Electric Utilities Association of the State of New York v. Power Authority of the State of New York</u> (PASNY), 21 FERC paragraph 61.021 (October 13, 1982), <u>PASNY v. FERC</u> , 743 F.2d 93 (2nd Cir. 1984)	FERC held that in the Niagara Redevelopment Act, the Congress defined the term "public bodies" as those governmental bodies that resell and distribute power to the people as consumers. The appellate court affirmed that preference rights under the act accrue to public bodies and nonprofit cooperatives that are engaged in the actual distribution of power. In determining the ultimate retail distribution of the power sold to them, public entities could resell the power to industrial and commercial users, not just to domestic and rural customers. The court also described "yardstick competition," a theory that underlies preference. The court stated that the Congress, while concerned with meeting the needs of rural and domestic consumers, believed that all interests could best be served by giving municipal entities the right to decide on the ultimate retail distribution of the preference power sold to them. This belief was founded on the so-called "yardstick competition" principle, which assumes that if the municipal entities are supplied with cheap hydropower, their lower competitive rates will force the private utilities in turn to reduce their rates, with resulting benefits to all, including rural and domestic consumers.
<u>Massachusetts Municipal Wholesale Electric Company v. PASNY</u> , 30 FERC paragraph 61, 323 (March 27, 1985)	FERC reaffirmed parts of an earlier decision interpreting the Niagara Redevelopment Act as providing allocations of preference power for states neighboring New York and clarified which states were included. FERC held that any public body or nonprofit cooperative in a state neighboring New York within economic transmission distance of the Niagara project is entitled to an allocation of preference power. FERC also held that only publicly owned entities that are capable of selling and distributing power directly to retail consumers are public bodies entitled to preference under the act.

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**Appendix I  
Compendium of Selected Statutes, Court  
Cases, and Administrative Rulings Relating  
to Preference**

Court cases	Relevant decision
<u>Disposition of Surplus Power Generated at Clark Hill Reservoir Project</u> , 41 Op. Atty Gen. 236 (1955)	The Attorney General construed section 5 of the Flood Control Act of 1944, providing preference to public bodies and cooperatives, to mean that if there are two competing offers to purchase federal power, one by a preference customer and the other by a nonpreference customer, and the former does not have at the time the physical means to take and distribute the power, the Secretary of the Interior must contract with the preference customer on condition that within a reasonable time fixed by the Secretary, the customer will obtain the means for taking and distributing the power. If within that period the preference customer does not do so, the Secretary is authorized to contract with the nonpreference customer, subject to the condition that should the preference customer subsequently obtain the means to take and distribute the power, the Secretary will be enabled to deal with the preference customer. The Secretary's duty to provide preference power is not satisfied by the disposition of the power to a nonpreference customer under an arrangement whereby the nonpreference customer obligates itself to sell an equivalent amount of power to preference customers.

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Legend

- BPA = Bonneville Power Administration
- FERC = Federal Energy Regulatory Commission
- SEPA = Southeastern Power Administration
- SWPA = Southwestern Power Administration
- TVA = Tennessee Valley Authority
- WAPA = Western Area Power Administration

# PMAs Affected by Selected Statutes Relating to Preference in the Sale of Electricity

Statute	Affected PMA(s)			
	BPA	SEPA	SWPA	WAPA
Reclamation Act of 1906	X			X
Act of September 18, 1922				X
Boulder Canyon Project Act (1928)				X
Bonneville Project Act of 1937	X			
Fort Peck Project Act (1938)				X
Reclamation Project Act of 1939	X			X
Water Conservation and Utilization Act (1940)	X			X
Hungry Horse Dam Act (1944)	X			
Flood Control Act of 1944	X	X	X	X
Rivers and Harbors Act of 1945	X			
Act of September 30, 1950	X			
Act of June 18, 1954				X
Act of July 27, 1954	X			
Trinity River Division Act (1955)				X
Colorado River Storage Project Act (1956)				X
Flood Control Act of 1958				X
Flood Control Act of 1962				X
Act of December 23, 1963				X
Pacific Northwest Power Preference Act (1964)	X			X
Colorado River Basin Project Act (1968)				X
Pacific Northwest Electric Power Planning and Conservation Act (1980)	X			
Hoover Power Plant Act of 1984				X
National Defense Authorization Act for Fiscal Year 1994				X
Energy and Water Development Appropriations Act, 1996	X			

#### Legend

BPA = Bonneville Power Administration  
 SEPA = Southeastern Power Administration  
 SWPA = Southwestern Power Administration  
 WAPA = Western Area Power Administration

# Comments From the Bonneville Power Administration



**Department of Energy**

Bonneville Power Administration  
Washington, D.C. 20585

April 6, 2000

In reply refer to: LP-7

Mr. Jim Wells, Director  
Energy, Resources, and Science Issues  
General Accounting Office  
441 G Street NW, Room 2T23  
Washington, DC 20548

Dear Mr. Wells:

Thank you for furnishing us with a copy of a Draft Report entitled Federal Power: The Evolution of Preference in Marketing Federal Power (GAO/RCED-00-127), dated April 2000. The Bonneville Power Administration (Bonneville) appreciates the opportunity the General Accounting Office (GAO) has provided us to review and comment on the draft of your report, sent to us on April 3, 2000, and to discuss our comments with GAO staff.

In general, please accept our compliments on a readable portrayal of the history of the preference concept in federal power sales and the social and public purpose bases for it. While various Bonneville staff members have provided detailed information to you, we still have several technical comments and suggestions that we hope will strengthen the detailed accuracy of the report. We would also like to bring to your attention the current policy position of the Administration on the "preference clause". Overall, we believe the report well serves the purposes intended.

We have done our best, in the limited time allowed for comments and processing, to provide the attached technical, editorial and policy comments. We believe the inclusion of these comments will improve the accuracy of your report and will help you improve the final product.

Again, thank you for allowing us the opportunity to comment on the Draft Report.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey K. Stier".

Jeffrey K. Stier  
Vice-President for National Relations

Enclosure

cc:  
R. Glick, S-1  
J. McDuffie, CR-2  
T. Meeks, PML

# Comments From the Department of Energy's Power Marketing Liaison Office



**Department of Energy**  
Power Marketing Liaison Office  
Washington, DC 20585

April 6, 2000

Mr. Jim Wells  
Director, Energy, Resources,  
and Science Issues  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Wells:

Thank you for the opportunity to review and comment on the draft report *FEDERAL POWER: The Evolution of Preference in Marketing Federal Power* (GAO/RCED-00-127). The Southeastern Power Administration, Southwestern Power Administration, and Western Area Power Administration (Western) have reviewed the draft report, and our technical and editorial comments are enclosed for your consideration.

The power marketing administrations (PMAs) have been continually evaluating their roles and policies in light of the changes occurring in the electric utility industry. I wish to bring to readers' attention the inquiry undertaken by Western regarding the impact of electric utility industry restructuring on Western's power allocation policies, published in the *Federal Register* on June 25, 1999 (64 FR 34433). The three PMAs would also like to associate themselves with Bonneville Power Administration's observation that the Clinton Administration does not support repeal of the "preference clause" as part of electricity restructuring legislation.

I hope you find the enclosed comments useful, and we appreciate your staff's willingness to share an advance copy with us.

Sincerely,

A handwritten signature in cursive script that reads "R. Jack Dadd for".

Timothy J. Meeks  
Assistant Administrator

Enclosure

cc: R. Glick, S-2  
J. McDuffie, CR-2  
J. Stier, BPA

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