Department of Energy
Washington, DC 20585

October 12, 2011

The Honorable Carolyn N. Lerner
Special Counsel
U.S. Office of Special Counsel
1730 M Street, NW, Suite 218
Washington, DC 20036-4505

SUBJECT: Supplemental Special Inquiry on Office of Special Counsel Whistleblower Disclosure File No. DI-10-1231: Allegations Regarding Western Area Power Administration's Desert Southwest Region

Dear Ms. Lerner:

This letter provides additional information requested by your Office concerning the subject whistleblower disclosure referenced above. It was alleged that the Western Area Power Administration, Desert Southwest Region (Western):

- Improperly provided 90 megawatts per hour of free electric transmission to Griffith Dynegy Energy, LLC (Griffith), a full-service energy provider; and,

- Violated Federal Energy Regulatory Commission (FERC) Order Nos. 888 and 889 by continuing to allow Griffith to receive free transmission.

We previously reported our conclusions on this matter in our Special Report "*Special Inquiry on Office of Special Counsel Whistleblower Disclosure File No. DI-10-1231: Allegations Regarding Western Area Power Administration's Desert Southwest Region*" (OAS-SR-11-01, May 2011). In our Special Report, we concluded that the allegations could not be substantiated.

Subsequent to issuance of our report, your office submitted written questions requesting additional information regarding this matter. You asked that we clarify certain aspects of our previous conclusions, as well as address additional statements made by the complainant to support the allegations. To enable us to respond to these questions, our team conducted on-site work at Western's offices in Phoenix, Arizona. Our work included conducting additional interviews with the complainant and Western officials; further reviewing pertinent documentation; and, completing additional substantive procedures necessary to provide a response to the questions.

Based on the supplemental evidence gathered and our related analyses, including an examination of the complainant's new concerns, our position of this matter has not changed. It remains our

conclusion that Western did not provide "free transmission" to Griffith and we found no evidence to support the allegation that FERC orders had been violated. Our responses to your specific questions, Enclosure 1, provide additional detail and discussion of the evidence that supports our conclusions on the allegations and on the additional statements made by the complainant.

OTHER MATTERS

As discussed in our May 2011 Special Report and previously discussed with your staff, during the course of our review we identified other matters related to the Griffith contracts that were outside the scope of the complainant's specific allegations. These matters related to appropriate revenue recognition and disclosure of discounts when redirecting transmission between systems. We have discussed these issues with Western officials and will be separately communicating these issues to management.

As requested during our last communication, a list of individuals we interviewed has been provided as Enclosure 2. If you have any further questions regarding this matter, please contact Rickey R. Hass, Deputy Inspector General for Audits and Inspections, at 202-586-1949 or Sanford Parnes, Counsel to the Inspector General, at 202-586-4393.

Sincerely,

Greg Friedman

Gregory H. Friedman
Inspector General

cc: Chief of Staff, U.S. Department of Energy

Enclosures

SPECIAL COUNSEL QUESTIONS AND
OFFICE OF INSPECTOR GENERAL RESPONSES

QUESTION 1: ***The report appears to begin by focusing on the question of whether Griffith received "additional" free transmission. The allegation was not that Griffith was provided additional transmission. The allegation was that Griffith received free transmission without additional cost. Building on that issue, it appears that the investigation zeroed in on the fact that Griffith has the option to deliver to two additional delivery points: McConnico or Peacock substations. The fact of the additional delivery points is not really a concern. The issue is that if Griffith chooses to deliver to one of those substations, free of additional charge, other customers are unable to use that transmission system, for which they would pay a fee. The whistleblower's contention is that such an agreement is unprecedented. Clarification of this point would be appreciated.***

To answer this question, we addressed three main points: 1) our conclusion that Western did not provide free transmission to Griffith; 2) the effect that the "additional delivery rights" provision in the Operation, Maintenance, and Replacement Contract (OM&R) had on other customers' access to Western's systems; and, 3) the complainant's contention that such an agreement was unprecedented.

Allegation Regarding Free Transmission

Inherent in the Complainant's allegation of free transmission was the underlying concern that the inclusion of the "additional delivery rights" in the OM&R in 2009, in substance, provided Griffith a financial benefit not available to other customers. Despite an extensive evaluation of the facts and circumstances surrounding Western's contractual and business relationship with Griffith, we could not substantiate the complainant's allegation that Griffith had been granted "free transmission without additional cost."

To fully understand Griffith's relationship with Western and the inclusion of delivery rights in the OM&R, we believe it is useful to provide some historical information. Griffith began its contractual relationship with Western in 1999. At that point, Griffith executed three transmission service agreements (TSA) to purchase 595 megawatt hours (MWh) of transmission from the Griffith Substation to the Mead Substation on the Intertie System. At the same time, Griffith entered into a Mutual Services Agreement (MSA) with Western, an agreement that specified a variety of maintenance and operational agreements. The MSA contained a provision that permitted Griffith, without additional charge, to deliver a portion of the total transmission capacity already purchased in these TSAs to two additional delivery points, the Peacock Substation on the Intertie System and the McConnico Substation on the Parker-Davis System. Essentially, the same provision regarding additional delivery points was later included in the OM&R, which replaced the MSA. Western officials informed us that the provision was not intended to provide free transmission and that this was clarified in the 2009 OM&R. Specifically, an additional clarifying clause was added to the OM&R to indicate that while Griffith would be able to use the additional delivery points, it could not exceed the total capacity (595 MWh) specified in the existing TSAs.

As documented in the Office of Special Counsel's (OSC) March 23, 2011 summary of the complaint, the Complainant's primary allegation was that in its negotiation of the OM&R Western "improperly provided 90 megawatts per hour (MWh) of free electric transmission to Griffith Dynegy, LLC (Griffith)." In our May 2011 Special Report, we concluded that the OM&R did not result in Western providing 90 MWh of free transmission to Griffith. Indeed, none of the contractual arrangements between Western and Griffith provided for "free transmission." As such, and after reviewing the complainant's allegation, we concluded that to have received "free electric transmission," Griffith would have had to receive transmission in excess of what it had purchased. We determined that Griffith did not have the right and had not received transmission in excess of what it had purchased. Therefore, Griffith had not and was not entitled to "free transmission."

Taken in isolation, the OM&R provision would appear to provide a financial benefit to Griffith that was not available to other customers. Specifically, Griffith was permitted to re-direct power to the McConnico Substation, resulting in the ability to redirect power from the Intertie System to the Parker-Davis System without additional cost. The ability to redirect power between Western's systems without additional cost is not a benefit ordinarily available to other customers. Typically, a customer would have to purchase new transmission on the Parker-Davis System, while continuing to pay the full cost of its commitment on the Intertie System. Western officials, however, asserted that a review of the history and circumstances surrounding these rights would reveal that Western had several reasons for offering this concession when negotiating the original 1999 agreements with Griffith.

Western officials told us that in 1999 they were struggling to attract new customers to the Intertie System and consequently offered an incentive of alternative delivery points. Western officials referred us to a 1996 General Accounting Office (GAO) report on Power Marketing Administrations that had questioned the financial viability of the Intertie System. Further, Western officials explained that due to lack of space at the site, Griffith was unable to co-locate its substation with the existing McConnico Substation as it had planned. Griffith project developers, who had financed extensive upgrades on the Intertie and Parker-Davis Systems preferred co-location. Alternatively, they proposed the establishment of a "common bus" arrangement where the Griffith, McConnico, and Peacock Substations would be treated as one common facility. Western officials explained that there was precedent for similar common facility arrangements in the electric utility industry at the time. Although Western did not allow the "common bus" arrangement, it did allow for the insertion of the "additional delivery rights" provision in the MSA as an alternative.

Officials indicated that at the time they negotiated the OM&R in 2009, Western believed that including the "additional delivery rights" – a provision originally contained in the MSA – would provide little real additional value. Officials implied Griffith could essentially achieve the same objective under provisions of an existing TSA. They also indicated the provision would not affect other customers because it was unlikely that others would or could take transmission between the Griffith Substation and McConnico or Peacock Substations. Based on interviews with officials and our own analyses, we concluded that, in effect, the inclusion of this provision in the OM&R, the subject of the complaint, would actually result in no additional financial benefit to Griffith than had existed for the past 10 years.

Even if Western had been successful in excluding the "additional delivery rights" provision from the OM&R, as recommended by the complainant, it would not have prevented Griffith from re-directing transmission to the McConnico Substation without additional cost as this right is separately provided for in Griffith's TSA #99-DSR-11034 (TSA-11034). TSA-11034, which was also executed in 1999, gave Griffith the right to re-direct transmission to any delivery point on the Parker-Davis System, without additional cost, for a period of 30 years. Therefore, in effect, the provision in the OM&R did not provide for an additional right that had not already existed under TSA-11034 and did not provide "free transmission without additional cost."

Effect on Other Customers

Based on the evidence gathered in our review of this matter, we concluded that the act of including the "additional delivery rights" provision in the OM&R contract in 2009, the specific subject of the complaint, has not and will not affect other customers for the following reasons:

- Western had not reserved special priority for Griffith to the McConnico and Peacock Substations as a result of the provision. While the OM&R provision states that Griffith **may** make deliveries to the Peacock and McConnico Substations, Western officials stated Griffith's delivery requests relying on the OM&R provision, if they were ever made, would be evaluated based on rules established in Western's Open Access Transmission Tariff (Tariff). We confirmed through queries of the transmission scheduling system that Western had established no reserved capacity for Griffith to the Peacock and McConnico Substations that would give it priority over other customers as a result of the "additional delivery rights." Based on this evidence, we concluded that other customers would not be prevented from purchasing transmission as a result of the "additional delivery rights" provision in the OM&R.

- The provision provided Griffith with no additional benefit than already existed since 1999 under the Tariff and other existing agreements. Had the OM&R excluded the "additional rights provision," Griffith would still have been able to re-direct power to the Peacock Substation under Section 22 of Western's Tarriff and to the McConnico Substation under a provision in TSA-11034. Therefore, because these rights had been in effect since 1999, the inclusion of the provision in question in the OM&R in 2009 did not have any additional effect on other customers.

- Griffith had never executed this provision since the authority was first granted in 1999. Per Western officials, to the best of their knowledge, Griffith had never exercised the "additional delivery rights" provided by either the MSA or the OM&R since they were originally granted in 1999. We requested a report from Western's automated scheduling system of all instances where Griffith had re-directed transmission to the Parker-Davis System from 2004 to 2011, the period for which data was available. We found that while Griffith had re-directed power to alternative delivery points on the Parker-Davis System, these transactions had never been executed using the "additional delivery rights" granted in the MSA or OM&R, but rather were specifically executed through the rights granted in

TSA-11034. Further, during our discussions on this matter, the complainant acknowledged awareness that the OM&R "additional delivery rights" provision had never actually been exercised by Griffith.

Unprecedented Nature of Griffith Contract Terms

Officials told us that, to their knowledge, Western had not made similar agreements with other entities. The unique nature of the 2009 OM&R and the 1999 TSA-11034 and MSA may have led the complainant to conclude that Griffith received special preference. Western officials, however, provided what they believed to be a reasonable explanation for the unprecedented nature of the agreements. As previously explained, Western reported that during the 1990s, it had aggressively marketed the under-utilized Intertie System and granted the re-direct authority to Griffith as an alternative to providing a "common bus" arrangement. Further, it appears that the original terms and conditions negotiated with Griffith and documented in the MSA and TSA-11034 benefited both Griffith and Western when history and circumstances were considered. According to Western officials, these agreements allowed the deal to close and Western to obtain the considerable economic benefits provided in the TSAs, including guaranteed transmission revenue. The MSA and TSA-11034 were legal and binding agreements at the time the OM&R was negotiated.

QUESTION 2: ***The whistleblower disagrees with the report's characterization that because there is no prohibition on including such a clause in an OM&R, it is therefore appropriate to do so. The whistleblower reiterated that there is no such language in any of Western's OM&Rs with any of its other customers. In fact, she noted that every other customer that has a transmission agreement with Western uses the form Application for Transmission Service, included in Western's Tariff. The Tariff requires that all transmission agreements be executed using the standard form described therein. Although the report finds that Western is not required to follow FERC Orders as a public utility, Western does operate under its own Tariff. Thus, the whistleblower contends that pursuant to the Tariff, Griffith should have executed an application for transmission, which it did not do. In our conversation on August 2, we discussed the fact that WAPA views the Tariff as flexible, and can choose to use or not use it as it sees fit. Additional explanation and support for this determination would be helpful.***

To answer this question, we addressed three main points: 1) the appropriateness of including the "additional delivery rights" provision in the OM&R; 2) whether the OM&R's "additional delivery rights" provision represented a transmission agreement and therefore required Griffith to execute an application for transmission; and, 3) Western's responsibility under its Tariff.

Appropriateness of the Provision in the OM&R

As we discussed in our May 2011 Special Report, there appears to be no prohibition to including the "additional delivery rights" provision in the OM&R. While it may not be standard practice to include such a provision in an OM&R, we found no law, regulation, policy, or procedure that prohibited it. The complainant also did not question the decision to provide these rights in the 1999 MSA, only the continued inclusion of these rights in the 2009 OM&R. As discussed in our

May report, we could find no evidence to indicate that the MSA was no longer in effect at the time the parties negotiated the OM&R. Since the OM&R was accomplished through a negotiation process, Western officials explained that they were not in a position to unilaterally exclude the provision from being carried forward from the MSA to the OM&R.

Finally, the complainant alleged that the original "additional delivery rights" were granted as incentive for Griffith to join the Western Area Lower Colorado Balancing Authority and therefore, upon Griffith's departure from the Balancing Authority, it was no longer appropriate to continue providing this incentive. However, as previously discussed, Western officials noted a number of other reasons why Griffith was granted the original rights in 1999. These reasons included Western's need to aggressively market the Intertie System at that time. By including these rights in the MSA, Western officials stated that they were able to secure the execution of TSAs with Griffith that guaranteed transmission service fees for a period of 30 years. Griffith's departure from the Balancing Authority did not affect these TSAs which remain in effect today.

Transmission Agreement and Application for Transmission

We were unable to substantiate the complainant's statement that the "additional delivery rights" provision represented a "transmission agreement" and therefore required that Griffith complete a standard "Application for Transmission Service." After reviewing available evidence concerning the nature of this provision, we determined that the provision appeared to not represent a new "transmission agreement," but rather a modification of specifications to the three existing "transmission agreements." We reviewed the Tariff and found that under specific conditions, Section 22 of Western's Tariff allows customers to modify the delivery points for transmission service without additional cost, without submitting an "Application for Transmission Service," and without executing a new TSA. Specifically, the Tariff states:

- "Modifications on a Non-Firm Basis: The Transmission Customer taking Firm Point-To-Point Transmission Service may request the Transmission Provider to provide transmission service on a non-firm basis over Receipt and Delivery Points other than those specified in the Service Agreement ("Secondary Receipt and Delivery Points"), in amounts not to exceed its firm capacity reservation, without incurring an additional Non-Firm Point-To-Point Transmission Service charge or executing a new Service Agreement." [Tariff 22.1]

- "Service over Secondary Receipt and Delivery Points on a non-firm basis shall not require the filing of an Application for Non-Firm Point-to-Point Transmission Service under the Tariff." [Tariff 22.1(d)]

Based on our analysis, this guidance could reasonably be applied to the "additional delivery rights" provision as 1) Griffith has taken firm point-to-point service from Griffith Substation to Mead Substation; 2) the provision modifies the delivery points of that transmission service; 3) we found no evidence indicating that the modifications were on a firm basis; and, 4) the OM&R provision states that Griffith may not exceed its existing firm capacity.

Additionally, Western officials asserted that the provision did not represent a "transmission agreement;" but was rather a "condition of interconnection." Specifically, as a condition of interconnecting to Western's transmission system in 1999, Griffith was granted these "additional delivery rights" in lieu of either co-locating the Griffith and McConnico Substations or granting a "common bus" arrangement. As such, Western officials consider the "additional delivery rights" to be "interconnection or facility arrangements" rather than transmission and that is why the rights were not included in "transmission agreements."

Western's Responsibilities Under its Tariff

It was never our intent to suggest that Western views its Tariff as flexible and can therefore choose to use or not use it as it sees fit. As our previous report states, although Western is not subject to Federal Energy Regulatory Commission (FERC) orders, Western created and submitted to FERC an Open Access Transmission Service Tariff comparable to those required of public utilities under FERC Order No. 888. Western officials told us that this was done to implement the Department of Energy's Open Access Transmission Policy which states that the Power Marketing Administrations will comply with the principles set forth by FERC to the extent consistent with applicable law. Additionally, Western officials explained that by establishing a comparable Tariff, Western has been granted "safe harbor" status by FERC, and therefore other utilities must give Western equal and open access to their systems. Although Western is not required to comply with FERC orders, Western officials stated that significant violations of its Tariff could result in FERC's revocation of its "safe harbor" status.

QUESTION 3: ***The whistleblower also disagreed with the report's finding that when Griffith left the Balancing Authority there was no effect on its transmission rights. In fact, in Griffith's original MSA, Contract, Section 4, subsection 4.2, it states, "Griffith may terminate this contract upon (6) months' advance written notice given to Western. Such notice shall include the date upon which the facilities of Griffith are to be disconnected from the Transmission System…." Thus, pursuant to Griffith's original contact, leaving the BA should automatically coincide with termination of Griffith's transmission rights. We understand that the agency's contention is that the MSA was not terminated, but rather transferred directly into the OM&R. This appears to lead back to the whistleblower's contention that transmission services should not be addressed in an OM&R in the first place, pursuant to Western's Tariff. If this clause in particular could be addressed more fully, it would be informative. You noted in our conversation that you were hoping to review the Tariff that was in place when the original agreements were executed; if it is possible to include an explanation of that Tariff and its relevancy that would be helpful, as well.***

We evaluated the complainant's statement that subsection 4.2 of the MSA supported the allegation that the MSA had been terminated upon Griffith's departure from the Balancing Authority, an assertion the complainant had not previously discussed with us during our initial review of the allegations. We determined that the additional information provided by the complainant did not change our original conclusion that the MSA remained in effect when Western and Griffith were negotiating the OM&R in 2009.

Section 4.2 of the MSA describes the ability of Griffith to terminate the MSA, how such termination is to be communicated, and when termination would take effect. The section states, "Such notice shall include the date upon which the facilities of Griffith are to be disconnected from the Transmission System, or the date upon which any superseding agreement between Western and Griffith shall take effect as may be mutually agreed upon by the parties." Based on Western officials' assertions and our own independent analysis, we determined that Griffith's termination of Balancing Authority services did not result in its being "disconnected from the Transmission System." In fact, language in the OM&R itself provides evidence that Griffith remains connected to Western's systems. Therefore, since Griffith did not disconnect its facilities from Western's transmission systems, we concluded that the MSA remained in effect until the OM&R was executed, the OM&R being a "superseding agreement" that was "mutually agreed upon by the parties."

We concluded that leaving the Balancing Authority was not synonymous with disconnecting from Western's transmission systems. In fact, if such were the case, there would have been no need for the parties to execute the OM&R in question after Griffith departed the Balancing Authority. The OM&R documents operation, maintenance and replacement of equipment in regard to Griffith's physical connection of its facilities to the Western Transmission System. Section 2.2 of the OM&R states that Griffith "has constructed an electrical generating station and associated ancillary facilities located nine (9) miles southwest of Kingman, Arizona, near the Griffith interchange and Interstate Route 40 and **has connected these facilities** to the Western Transmission System." Additionally, section 8.2 of the OM&R states, "Western will provide such interconnection service as necessary to allow Griffith to continually interconnect the Power Plant to the Transmission System at the Interconnection Points and will provide such interconnection service as will be required by Griffith to make sales of electric energy and capacity from the Power Plant." Finally, section 5.2 of the OM&R has similar language to the MSA concerning termination of the contract, stating, "Such notice shall include the date upon which Contractor's facilities are to be disconnected from the Western's Transmission System." Had Griffith disconnected from Western's Transmission System, this clause would not have been necessary.

It is important to note that Balancing Authority services were only a subset of the relationship between Western and Griffith. The original 1999 MSA documented a range of agreements between the parties including Griffith's interconnection of its facilities to the Western Transmission System; Griffith's participation in the Western Area Lower Colorado Control Area (WALC) Balancing Authority; the operations, maintenance and replacement of equipment; and, miscellaneous agreements such as the "additional delivery rights." In 2002, the parties executed a separate agreement, the WALC Control Area Agreement (02-DSR-11332), to govern Griffith's future participation in the Balancing Authority. At that time, the MSA was amended to delete previous agreements related to Griffith's participation in the Balancing Authority. The amended MSA, including the "additional delivery rights" provision, remained in effect until replaced by the OM&R.

Additional evidence supporting that the MSA, as amended, remained in effect at the time the parties were negotiating the OM&R include:

- Griffith's notice of termination of its participation in the Balancing Authority explicitly references terminating the WALC Control Area Agreement, not the MSA;

- The OM&R states "the MSA, as amended, is **hereby terminated** and replaced with this Contract. All remaining funds under the MSA shall be transferred over to this Contract No. 09-DSR-12045." (OM&R 4) This language supports the conclusion that the MSA, as amended, remained in effect until it was terminated by the execution of the OM&R; and,

- The OM&R contains other language supporting the conclusion that the MSA was not terminated upon Griffith's departure from the Balancing Authority, but rather due to a mutual agreement to replace the MSA with the OM&R.

    - "Due to the changed relationship between the Contractor and Western, the Parties **wish to provide for the replacement** of the MSA, as amended, with this operation, maintenance, and replacement contract." (OM&R 2.9)

    - "The Parties **desire to replace the MSA**, as amended, and provide herein for ownership, operation, maintenance, and replacement of their associated facilities." (OM&R 2.10)

In our answers to the first two questions, we discussed the relevant portions of the Tariff regarding modifications of transmission services to allow for alternative delivery points and whether those modifications represented "transmission agreements" requiring a new TSA or "Application for Transmission Service." We saw nothing in either the current Tariff, or the Tariff existing in 1999, that would preclude the inclusion of the "additional delivery rights" provision in the OM&R.

Western Officials Interviewed Regarding OSC File No. DI-10-1231

Name	Job Title
John Bremer	Attorney, Office of General Counsel
John Dake	Power System Dispatcher
Carolyn Donnelly	Public Utilities Specialist
Debbie Emler	Power Marketing Manager
Doug Harness	Attorney, Office of General Counsel
Brenda Jefferson	Reliability Compliance Specialist
Mike McElhany	Transmission Business Unit Manager
Tony Montoya	Chief Operating Officer
Ron Moulton	Transmission Services Manager
Jack Murray	Rates Manager
John Steward	Transmission Business Unit Staff
Brian Young	Supervisory Public Utilities Specialist