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COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

B-202671

MAY 27, 1981

The Honorable George Miller
House of Representatives



115408

Dear Mr. Miller:

Subject: Information on the Resale of
Federal Project Water Supplies
by Intermediaries (CED-81-102)

On April 8, 1981, we met with you to discuss our findings on your requests of April 30, 1980, and January 8, 1981, concerning the resale of Federal water supplied under contracts to State and local governments or districts (hereinafter referred to as intermediaries 1/). We agreed to provide information for five Water and Power Resources Service and Army Corps of Engineers reservoirs on the following matters:

- Supplemental (in excess of amounts contracted for) water deliveries to intermediaries, their resales, and resale profits.
- Requirements that the Resources Service and the Corps be notified of and approve intermediary resales.
- Secretary of the Interior's authority to establish price and profit 2/ controls and to require expedited repayments for resales in contracts with intermediaries.

1/An intermediary is an entity that has purchased water or reservoir storage space from the United States under a contract. The intermediary (or the United States on behalf of the intermediary) resells the water or storage space to a water consumer. For the cases discussed in this report, the intermediary (under a water resale agreement) only markets the water. The intermediary does not distribute, treat, or supply the water to consumers. In effect, the intermediary is the middleman between the United States that supplies the water and the consumer that uses the water.

2/For purposes of this report, profit is defined as the amount of the intermediary's revenues in excess of his/her costs from resales to water consumers.

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SUMMARY OF FINDINGS

- No intermediaries have received supplemental water deliveries in the last 5 years.
- At three reservoirs, Pathfinder, Fontenelle, and Wynoochee, water has been resold; at the other two reservoirs, Fort Peck and Ruedi, potential water consumers have requested water sales contracts.
- The intermediaries resold the water at amounts substantially in excess of their costs (payments to the Federal project for the water supply).
- The Resources Service contracts require that the contracting officer be notified of and approve intermediary water resale agreements. Such requirements were not included for water resales in the Corps contract; however, the Corps was notified of the resale. The Corps contract does require notification and approval for the sale of reservoir storage space.
- The Secretary of the Interior has the general authority for new or amended contracts and, under certain circumstances for existing contracts, to establish price or profit controls over intermediaries' water resales as well as require expedited repayment.

To obtain the requested information, we selected the five reservoirs with actual or potential water resales which were identified in another GAO review of repayment policies and practices for Federal water resources projects with unsold water supply. As agreed with your office, we did not seek to determine all existing or pending water resale agreements. The areas covered in that review include Corps offices in Tulsa, Oklahoma, and Portland, Oregon, and Resources Service offices in Billings, Montana; Boise, Idaho; Denver, Colorado; Amarillo, Texas; and Salt Lake City, Utah. The five projects are

- Pathfinder Reservoir in Wyoming (Resources Service),
- Fontenelle Reservoir in Wyoming (Resources Service),
- Wynoochee Reservoir in Washington (Corps),
- Fort Peck Reservoir in Montana (Corps), 1/ and
- Ruedi Reservoir in Colorado (Resources Service).

1/Although the Fort Peck Reservoir is a Corps of Engineers project, its water supply was marketed by the Department of the Interior under a memorandum of understanding of Feb. 24, 1975. Therefore, we are considering it as a Resources Service reservoir for the matters covered in this report.

We interviewed Corps and Resources Service field officials, analyzed agencies' policies and practices, and examined the contracts between the Federal agencies and the intermediaries and the intermediaries' water resale or pending resale agreements. In all cases, we met with either the intermediary (or a potential Ruedi intermediary) or the water consumer.

SUPPLEMENTAL DELIVERIES

Regional agency officials responsible for marketing water from the five reservoirs said that during the last 5 years their agencies made no supplemental (amounts in excess of those contracted for) water deliveries to intermediaries. If an intermediary sold all the water under contract with a Federal agency, a second contract would be written for an additional water supply.

For example, in 1962 the Resources Service sold to the State of Wyoming 60,000 acre-feet of reservoir capacity in Fontenelle Reservoir; in turn, the State of Wyoming sold the 60,000 acre-feet of water to two energy companies. In 1974 the Resources Service contracted with Wyoming for another 125,000 acre-feet of storage and water rights. Although the water has not yet been sold, Wyoming offered the additional 125,000 acre-feet for sale to any potential buyers State officials could identify.

INTERMEDIARIES' REALES AND PROFITS

We identified water resale agreements for three of the reservoirs: Wynoochee, Pathfinder, and Fontenelle. The other two reservoirs have also received requests for resale agreements.

Sales of Water or Storage Space from Federal
Reservoirs Through Intermediaries

<u>Reservoir</u>	<u>Inter- mediary</u>	<u>Acre feet - annually</u>		
		<u>Sold to intermediary</u>	<u>Resold to third party Amount</u>	<u>Water consumer</u>
Pathfinder (Resources Service)	Local irrigation district	a/1,000	1,000	Pacific Power and Light Co.
Fort Peck (Resources Service)	State of Montana	300,000	0	-
Ruedi (Resources Service)	-	-	-	-
Fontenelle (Resources Service)	State of Wyoming	60,000	35,000	Pacific Power and Light Co.
			25,000	Sun Oil Co.
Fontenelle (Resources Service)	State of Wyoming	b/125,000	-	-
Wynoochee (Corps)	City of Aberdeen	26,400	9,217	Washington Public Power Supply System
Wynoochee (Corps)	City of Aberdeen	c/18,200	-	-

a/The water was sold by Resources Service directly to the water consumer on behalf of the intermediary, and revenues from the sales were credited to the intermediary.

b/This agreement includes the transfer of water rights and the right to use reservoir storage space.

c/Although 18,200 acre-feet is under contract to the city of Aberdeen, the city is not required to pay for any cost associated with this storage space until the space is used.

An energy company has requested water under the State of Montana's Fort Peck contract. Also, several contractors have requested water from Ruedi Reservoir. While such sales have not yet been consummated, the Resources Service has indicated that any water sales contracts with water consumers will be assignable to a local conservation district or the State of Colorado.

Because the Federal agency supplies the water to the consumers, the intermediary's resale cost is essentially limited to its payment for the water and its resale marketing expenses. Under such circumstances, it is reasonable to conclude that the difference between what the intermediary receives for the resale and its payment to the United States for that water supply is, for the most part, profit. A discussion of the three water resales follows.

Fontenelle Reservoir

In 1962 the Resources Service sold to the State of Wyoming 60,000 acre-feet of reservoir capacity under a 50-year contract for \$32,600 per year plus operating and maintenance expenses. In turn, Wyoming sold the water to two energy companies for about \$265,000 per year plus operating and maintenance expenses.

Pathfinder Reservoir

In 1979 and 1980 the Resources Service issued two temporary 1-year 500-acre-foot contracts for water to an energy company. The charge in 1979 was \$12,500 and in 1980, \$25,000. These revenues were then credited to the intermediary's account as required by its contract with the Resources Service. The intermediary pays the Resources Service less than \$500 a year for the water resold to the energy company. In effect, the Resources Service, on behalf of the intermediary, sold water to the energy company. Although Pathfinder is a Resources Service reservoir, all revenues from the water resales benefited the intermediary.

Wynoochee Reservoir

In June 1980, the city of Aberdeen, Washington, sold for \$10,950,000 a 9,217-acre-foot annual water supply for 40 years from the Wynoochee Reservoir to the Washington Public Power Supply System and several utilities. The water is to be used in the Satsop nuclear powerplant. For the sale, the city received \$9 million in cash and \$1,950,000 (plus interest at 9 percent per year) to be paid in installments beginning the year after the startup of the powerplant.

Because current payments to the Corps are about \$100,000 per year, the city was able to place \$7.7 million in a trust fund and invested the moneys in U.S. Treasury securities. The

payments to the Corps will increase in 1983 to about \$648,000 a year for construction costs. The annual operating and maintenance costs are not known at this time.

The city estimates that the fund will be sufficient to repay the construction cost and deferred operating and maintenance expenses the city owes the United States for the 26,400 acre-feet of water. The balance of the \$9 million in revenues is available to pay current operating and maintenance expenses and other possible Corps contract requirements. Such future expenses are not determinable at this time.

The city does not know when it will sell the remaining water available from Wynoochee. City officials said that they did not know how much additional operating expenses they would incur and that this matter was being negotiated with the Corps.

Because the amounts of the future operating expenses and water sales are not known at this time, we cannot estimate the profit that the city of Aberdeen might realize from the sales of Wynoochee Reservoir water. If the city is unable to sell any remaining water and operating expenses escalate appreciably, profit may be minimal. If the city is able to sell the remaining water supply and expenses do not rise appreciably, substantial profits are possible.

According to Federal agency officials, water resale agreements are not common. However, it seems to us that water resales will increase as the water demand grows in the West, particularly to meet the water requirements for expected energy development and production. As the demand for the existing water supply increases, the market value of the water and the intermediaries' profit will rise correspondingly.

NOTIFICATION AND APPROVAL OF WATER RESALES

The Secretary of the Interior has the general authority to require notification of and to approve water resales by intermediaries. Each of the Resources Service contracts with intermediaries requires them to notify the Resources Service of any resale agreements. In addition, the contracts require the Department of the Interior's approval for each resale agreement. In contrast, the Corps contract does not require notification or approval of water resales from Wynoochee Reservoir.

The Secretary's general authority, 343 U.S.C. 373, provides:

"The Secretary of the Interior is authorized to perform any and all acts and to make such rules and regulations as may be necessary and proper for the purpose of carrying out the provisions of this Act [Reclamation Act] into full force and effect."

Therefore, contracts between intermediaries and the Department of the Interior's Water and Power Resources Service, for projects constructed under reclamation law, are subject to the act's provisions. This is often explicitly stated in the contracts. Also, such contracts often incorporate a provision regarding the sale or transfer of water.

As an example of the notification requirements, the contract between the United States and the State of Montana for water from the Fort Peck Reservoir states:

"The form of such subcontracts shall be subject to approval by the Contracting Officer representing the United States and a copy of each executed subcontract shall be provided by the Department [Montana] to the Contracting Officer."

The contract between the Corps and the city of Aberdeen for sales of water from Wynoochee Reservoir does not require notification of water resale agreements. The contract states that:

"The City shall not transfer or assign this contract nor any rights acquired thereunder, nor sub-allot said water or any part thereof, nor grant any interest, privilege of license whatsoever in connection with this contract, without the approval of the Secretary of the Army or his authorized representative; provided that this restriction shall not be construed to apply to any water which may be obtained from the water supply storage space by the City and furnished to any third party or parties * * *."

Both Corps and city officials interpret this provision to mean that such approval would be required for the sale of reservoir storage space but that it would permit water sales from Wynoochee without Corps notification or approval. However, the Corps was notified of the water resale agreement and was provided with a copy of the agreement.

PRICE AND PROFIT CONTROLS
AND EXPEDITED REPAYMENT

Secretary's authority

You asked whether the Secretary of the Interior, when approving or disapproving water resales, has the authority to compel sellers to repay portions of their profits to the United States, impose price controls in new contracts, and limit profiteering in existing contracts.

We believe that if the Secretary has given final approval to contracts for the resale of a Federal water supply under which an intermediary will retain the difference between its

cost (including administrative expenses) and the amount received from a third party, Interior is bound by such terms in the absence of fraud or arbitrary or capricious action. However, if the intermediaries, for example, request supplemental (additional) water supplies, or if contracts are to be amended, the Secretary then has the opportunity to establish price or profit limitations.

Under the Secretary's general authority, and the provisions of 43 U.S.C. 392a on covering moneys received from irrigation projects into the reclamation fund, we believe that, for existing contracts, the Secretary may require his consent for intermediaries to sell their Federal water supply in ways not contemplated in the project's authorization act (for example, an irrigation district sells water to a power company for energy production). Where not contrary to the underlying contract with an intermediary or the specific project authorization act, the net proceeds of the resale could be required to be paid into the reclamation fund. Also, if the Secretary so desires, he could, as a condition of his approval of the resale, limit the price charged a third party to that paid by the intermediary plus expenses of the resale and, in this way, preclude a profit.

Price and profit controls on contracts

For the five reservoirs, only one of the contracts between the United States and an intermediary includes a provision which directly limits the prices that the intermediary can charge for the resale of Federal project water. This is the Montana water resale contract (Fort Peck Reservoir) referred to in your request.

The September 30, 1976, contract for industrial water supply from the Fort Peck Reservoir permits the State of Montana to subcontract with industry for water sales up to an annual quantity of 300,000 acre-feet. For water sales under a subcontract, Montana must pay the United States an annual rate of \$20 per acre-foot.

In addition to the \$20 per acre-foot fee, Montana may collect an amount equal to the Federal charge to cover its costs:

"The subcontractor may also be required to pay an additional annual charge to the Department [Montana] to cover costs (associated with contract administration and ancillary State expenses associated with the contract) * * *: Provided, that any such additional annual charges payable to the Department shall not be greater than the charges which are then payable to the United States * * *."

Montana included a \$5 charge per acre-foot in a contract proposal with an energy company. The proposed contract price was for \$25, with \$20 to be remitted to the United States; however, the contract was not consummated.

None of the other contracts include any restrictions on prices or profits. However, because Interior must approve all resale agreements with third parties, it could through this requirement, under the circumstances previously discussed, limit prices or profits. The Corps contract, however, does not require approval for third-party water sales. Therefore, the Corps does not have a similar opportunity to limit intermediaries' prices or profits.

Expedited repayment

One contract requires accelerated repayment if the intermediary profits from water sales. The others do not, regardless of how much the intermediary may profit.

The 1974 Fontenelle contract for the sale of 125,000 acre-feet of reservoir storage and water rights requires expedited Federal cost recovery if the State profits on water sales. That provision states:

"For those contracts which are executed between the State and a third party and which provide revenues to the State in excess of that required to be paid to the United States, as specified herein, the State agrees that 50 percent of such excess revenues will be returned to the United States and will be applied to the unpaid balance of the repayment obligation, including interest, * * *. Any such revenues so applied will accelerate the repayment of the State's obligation."

Your letter asked for a copy of a Resources Service contract (with a Colorado purchaser) which requires repayment of capital costs in 10 years rather than the normal 40-year period permitted by reclamation law. The project in question is the Ruedi Reservoir in Colorado. While the Resources Service has offered to sell Ruedi water at prices which, if accepted, would provide capital cost repayment in about 10 years, such water sales have not been consummated. The Resources Service told us that they are still negotiating with prospective contractors and that contract terms have not been agreed to.

Concerning the capability of applying expedited repayment periods for new Resources Service projects and contracts, the Secretary of the Interior now has the authority to require

repayment in less than 40 years unless the exercise of his discretion is prohibited, for example, by a project's authorization act. If the Congress desires to make repayment in less than 40 years mandatory, then such a legislative requirement must be enacted.

In summary, we believe that the Secretary of the Interior has broad authority to limit the prices charged by intermediaries for the resale of water from Federal projects. Also, the Secretary could, in appropriate cases, require that amounts received by intermediaries in excess of their costs and administrative expenses (profits) be paid into the reclamation fund.

If it is desired to limit the Secretary's discretionary powers under his general authority and ensure that third parties do not pay exorbitant prices for Federal water purchased from an intermediary, then legislation would need to be enacted. In this respect, we noted that section 7 of your bill, H.R. 2606, requires that the Secretary of the Interior, in reviewing applications for the resale of water, establish resale prices which shall prevent speculation by contractors (intermediaries).

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At your request, we did not obtain written agency comments. However, the matters covered in this report were discussed with the agencies' field as well as headquarters officials and their comments are included in this report where appropriate.

As arranged with your office, we are sending copies of this report to the Director, Office of Management and Budget, and to the Secretaries of the Interior and the Army. Copies will also be available to other interested parties who request them.

Sincerely yours,



Henry Eschwege
Director