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May 24, 2005

VIA ELECTRONIC MAIL & FIRST CLASS MAIL

Oregon Public Utility Commission
550 Capitol St. NE, #215
PO Box 2148
Salem, OR 97308-2148
Attn: Filing Center

Re: In the Matter of the Request of Pacific Power and Light
Klamath Basin Irrigation Rates -- OPUC Docket No. UE-171

Dear Filing Center:

Enclosed please find an original and one copy of Klamath Water Users Association's Motion to Admit Exhibit and Estop PacifiCorp.

Should you have any questions regarding this matter, please call.

Very truly yours,

Edward A Finklea

Edward A. Finklea

EAF/tr
Enclosure
cc: UE-171 Service List (via email & first class mail)

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 171

In The Matter of PACIFIC POWER & LIGHT (dba PACIFICORP) Klamath Basin Irrigation Rates.	)	KLAMATH WATER USERS ASSOCIATION MOTION TO ADMIT EXHIBIT AND ESTOP PACIFICORP

INTRODUCTION

Pursuant to OAR § 860-013-0031, the Klamath Water Users Association ("KWUA") moves to add the attached Ninth Circuit brief ("Exhibit A") to the record and estop PacifiCorp from denying certain representations that it made in the Exhibit. In support of this Motion, KWUA states as follows:

BACKGROUND

The Commission initiated the above captioned proceeding to determine whether, as a matter of law, the power rate specified in a 1956 contract between PacifiCorp and the United States Bureau of Reclamation ("1956 Contract") should be terminated as of April 16, 2006. On May 12, 2005, PacifiCorp filed a Reply brief in which it asserted that the members of KWUA are not third-party beneficiaries of the 1956 Contract. PacifiCorp argued:

> "The remaining On-Project customers cannot rely on Section 35 [of PacifiCorp's FERC license for Project No. 2082] for asserting that the rates under the USBR Contract must continue under an annual license. *See Klamath Water Users Protective Ass'n v. Patterson*, 204 F3d 1206 (9th Cir. 2000)(holding that irrigators were not third-party beneficiaries to the USBR Contract and therefore lacked legal standing to enforce its terms.)"

In re PacifiCorp, Klamath Basin Irrigation Rates, OPUC Docket UE-171, PacifiCorp's Reply Brief, p. 6. In other words, PacifiCorp argues that the *Patterson* case stands for the proposition that KWUA members are not third-party beneficiaries of the 1956 Contract with respect to power rights.

PacifiCorp's contention cannot be squared with the representation PacifiCorp made to the Ninth Circuit in the *Patterson* case. PacifiCorp argued:

> The failure of the contracting parties to designate plaintiffs as express third-party beneficiaries with respect to irrigation water is particularly significant in this case because the parties knew how to express an intent to confer a direct benefit on third parties. In Article 5 of the 1956 contract, Copco agrees to provide electric power to project irrigators (a discrete, identifiable group) at an on-peak rate of 5 mills per kwh. (SER-85.) ***This promise confers on third parties an intentional, direct, and specifically identifiable benefit: the right to electric power at a rate better that the preexisting market rate.*** Thie 1956 contract contains no similar promise with respect to water * * *.

Exhibit A, p. 36. (Emphasis added.) The Ninth Circuit apparently agreed with PacifiCorp, as it determined that the on-project irrigators—the KWUA members—are not third-party beneficiaries of the 1956 Contract with respect to water. The Commission should recognize that PacifiCorp—through the same law firm that is representing it in this proceeding—submitted to the Ninth Circuit a signed pleading in which it expressly contended that the on project irrigators are third- party beneficiaries for power under the 1956 Contract.

ARGUMENT

KWUA moves to add Exhibit A to the record in the above captioned proceeding. Exhibit A is directly relevant to PacifiCorp's contention that the on-project irrigators are not third-party beneficiaries of the 1956 Contract with respect to power. In fact, as demonstrated in Exhibit A, PacifiCorp took a contrary position before the Ninth Circuit and represented that the on-project irrigators are third-party beneficiaries with respect to power. Exhibit A, p. 36. As such, Exhibit

A will be helpful to the Commission in deciding the merits of this case. Moreover, because PacifiCorp raised this argument for the first time in its Reply Brief, KWUA has not previously had the opportunity to respond or otherwise place Exhibit A in the Record. Finally, because counsel for KWUA read from a portion of Exhibit A during oral argument on May 19, 2005, it would be fair to all parties to have a complete written version of the document in the Record for all parties to this proceeding to review.

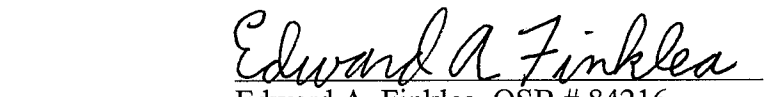
KWUA also moves to estop PacifiCorp from contending that the on-project irrigators are not third-party beneficiaries of the 1956 Contract with respect to power. Under Oregon law, the doctrine of judicial estoppel operates to bar a party from assuming a position in a legal proceeding that is inconsistent with the position that the same party has successfully asserted in a different judicial proceeding. *See generally Hampton Tree Farms, Inc. v. Jewett*, 320 Or. 599, 609, 892 P2d 683 (1995). As described above, PacifiCorp expressly asserted in the *Patterson* case that the on-project irrigators are third-party beneficiaries of the 1956 Contract for power but not third-party beneficiaries for water. In making this argument, PacifiCorp successfully persuaded the court that the on-project irrigators are not third-party beneficiaries with respect to water. Therefore, PacifiCorp should be estopped from now asserting that the on-project irrigators are not third-party beneficiaries with respect to power.

CONCLUSION

For the reasons described above, the Commission should grant KWUA's motion to add PacifiCorp's brief to the record and estop PacifiCorp from asserting that the on-project irrigators are not third-party beneficiaries with respect to power.

Dated this 24th day of May, 2005.

Respectfully submitted,



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Of Attorneys for
Klamath Water Users Association

CERTIFICATE OF SERVICE

I CERTIFY that I have on this day served the **KWUA'S MOTION TO ADMIT EXHIBIT AND ESTOP PACIFICORP** by electronic mail and/or mailing a copy properly addressed with first class postage prepaid to the following:

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Dated in Portland, Oregon, this 24th day of May 2005.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

KLAMATH WATER USERS PROTECTION ASSOCIATION, KLAMATH DRAINAGE DISTRICT, SAM HENZEL, and HENZEL PROPERTIES, LTD.,

Plaintiffs/Counter-Defendants/Appellants,

v.

ROGER PATTERSON, KARL E. WIRKUS, ELUID MARTINEZ, PATRICIA BENEKE, BRUCE BABBITT, UNITED STATES BUREAU OF RECLAMATION, and UNITED STATES OF AMERICA,

Defendants/Appellees,

PACIFICORP,

Defendant/Counter-Claimant/Appellee,

YUROK TRIBE,

Intervenor/Defendant/Appellee.

Ninth Circuit Court No. 98-35708

U.S. District Court (Oregon) Trial Court No. 97-3033-HO

ANSWERING BRIEF OF DEFENDANT/COUNTER-CLAIMANT/APPELLEE PACIFICORP

(continued on inside cover)

Appeal from the Order of the
United States District Court for the District of Oregon

The Honorable Michael R. Hogan, Judge

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CORPORATE DISCLOSURE STATEMENT

Fed R App P 26.1

PacifiCorp is a publicly held Oregon corporation.

STOEL RIVES LLP

Richard S. Gleason, OSB No. 81239

Of Attorneys for Defendant/
Counter-Claimant/Appellee
PacifiCorp

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Statutes and Rules

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I. STATEMENT OF JURISDICTION

Plaintiffs' statement is acceptable.

II. ISSUES PRESENTED

1. Did the district court correctly conclude that there were no disputed issues of material fact and that plaintiffs were not intended third-party beneficiaries of a 1956 contract between the U.S. Bureau of Reclamation ("Reclamation") and PacifiCorp?

2. May Reclamation dictate PacifiCorp's management of water under the 1956 Contract (defined herein) in order to balance competing demands for water needed to fulfill federal obligations relating to fish, wildlife, treaty rights, power generation, and irrigation?

III. STATEMENT OF THE CASE

PacifiCorp accepts plaintiffs' statement of the case. PacifiCorp also supplements the statement to provide context for that portion of PacifiCorp's Amended Counterclaim which plaintiffs moved the district court to dismiss. (*See* Appellants' Opening Brief ("App Br") at 51-59.)

The gravamen of plaintiffs' third-party beneficiary claim was that PacifiCorp and Reclamation illegitimately executed a 1997 modification of the 1956 Contract without first consulting and securing the consent of plaintiffs, the

alleged beneficiaries of the contract. That issue ultimately became the subject of the parties' cross-motions for summary judgment.

As a corollary to the third-party beneficiary claims, plaintiffs also contended that the 1956 Contract required PacifiCorp to operate the Link River Dam to protect the interests of the Klamath Project (the "Project") irrigators, such as plaintiffs, regardless of contrary directions from Reclamation. (Complaint at 15; Appellants' Excerpts of Record ("ER")-15.) PacifiCorp, on the other hand, believed the 1956 Contract did not vitiate its obligation to follow Reclamation's project operations decisions made pursuant to federal law obligations such as the Endangered Species Act (the "ESA") or tribal trust doctrine.

Therefore, to gain certainty for the future, PacifiCorp, through its counterclaim, sought from the district court declarations on *both* the third-party beneficiary/contract modification issues *and* the broader issue of whether PacifiCorp faced liability to plaintiffs under the 1956 Contract for implementing Reclamation's operational decisions. In particular, the latter declaration was requested in paragraph 17(c) of PacifiCorp's Amended Counterclaim, which reads:

> "PacifiCorp has no liability to plaintiffs under the 1956 Contract for implementing Federal Defendants' water allocations decisions for the Klamath Project." (ER 100.)

Plaintiffs moved to dismiss paragraph 17(c) of PacifiCorp's Amended Counterclaim on the grounds that it was not ripe and that it did not state a claim on which relief could be granted. (11/14/97 Plaintiffs' Memorandum in Support of Motion to Dismiss at 12-14; CR 152; Supplemental Excerpts of Record ("SER")-33-35.) The parties briefed this issue in addition to the third-party beneficiary issue. The district court denied plaintiffs' motion to dismiss and issued the declaration requested in paragraph 17(c) of the Amended Counterclaim. (4/27/98 Order at 17-18; ER-581-82).

Issues raised in paragraph 17(c) of the Amended Counterclaim and addressed by plaintiffs' motion to dismiss are covered in section VII, *infra*.

IV. STATEMENT OF FACTS

Plaintiffs' statement of facts includes irrelevant facts and numerous misinterpretations. PacifiCorp therefore offers the following alternative statement of facts. PacifiCorp also agrees with and refers the court to the district court's comprehensive recitation of the relevant facts. (4/27/98 Order at 2-8; ER-566-72.)

A. The History and Text of the 1956 Contract

The Project is located in the Klamath River and Lost River basins in southern Oregon and northern California and was authorized in 1905 pursuant to the Reclamation Act of 1902, as amended and supplemented. (Citing 33 Stat 714 (Act of Feb. 9, 1905)); Federal Defendants' Statement of Material Facts in Support of Summary Judgment on PacifiCorp's Counterclaim ("Fed's SOMF"), ¶ 1; CR 162; SER-52.) Construction on the Project began in 1906. (Fed's SOMF, ¶ 2; SER-52.)

Pursuant to a 1917 agreement between the California Oregon Power Company ("Copco") and the United States, Copco constructed the Link River Dam in 1921 to regulate the level of Upper Klamath Lake. (12/8/97 Declaration of Barbara D. Craig in Support of PacifiCorp's Opposition to Plaintiffs' Motion for Summary Judgment on PacifiCorp's Counterclaim ("Craig Decl"), Ex. 2; CR 191; SER-96-107.) When construction was complete, Copco conveyed the dam to the United States and operated it pursuant to the 1917 agreement. (Fed's SOMF, ¶ 2; SER-52.) With the dam, Upper Klamath Lake acted as a large reservoir for water for the Project, enabling Reclamation to expand the scope of the Project. At the same time, Copco's operation of the dam allowed it to optimize power generation at its downstream hydroelectric dams. (6/16/97 Declaration of Tim O'Connor in

Opposition of a Temporary Restraining Order ("O'Connor Decl"), ¶ 5; CR 31; SER-11-12.)

Project water users obtain water for irrigation purposes from the Project pursuant to contracts entered into with Reclamation under the Reclamation Act of 1902, as amended and supplemented. (Fed's SOMF, ¶ 3; SER-52.) These contracts are between Reclamation (not Copco or its successor PacifiCorp) and a water district or an individual water user. (*Id.*) The contracts provide that the district or water user will receive water for irrigation of a specified acreage, subject to the availability of water. (*Id.*)

Link River Dam is now operated and maintained by PacifiCorp, Copco's successor in interest, pursuant to the terms of a renewal of the 1917 contract entered into between the United States and Copco on January 31, 1956 (the "1956 Contract"). (Craig Decl, Ex 1; SER-82-95.) The 1956 Contract was entered into pursuant to the Reclamation Act of 1902, as amended and supplemented, and "acts of Congress relating to the preservation and development of fish and wildlife resources." (*Id.* at 1; SER-82.)

The only named parties to the 1956 Contract are the United States and Copco. Concerning those whom the contract is intended to benefit, Article 15 of the 1956 Contract provides that the pact

> "binds and inures to the benefit of the parties hereto, their successors and assigns, including without limitation any water user's organization or similar group which may succeed either by assignment or operation of law to the rights of the United States hereunder." (SER-89.)

The United States has not assigned any rights under the 1956 Contract to any water users' organization or similar group. (Fed's SOMF, ¶ 10 at 4; SER-54.) Nor has any such group succeeded to the interests of the United States by operation of law. (*Id.*)

In the 1956 Contract, Copco agreed to operate Reclamation's Link River Dam and to provide power at subsidized rates to the Project irrigators. In exchange, Reclamation granted Copco, within specified limits, discretion in storing water in and releasing water from Upper Klamath Lake, thus allowing Copco to regulate flows out of the lake to maximize hydroelectric generation at downstream dams. (O'Connor Decl, ¶ 5, ¶¶ 7-8; SER-11-12.) Thus Article 2 provides in pertinent part that, for a period of 50 years from the effective date of the 1956 Contract,

> "Copco may regulate the water level of Upper Klamath Lake between elevation 4143.3 and 4137, (Reclamation Service Datum), but the water level shall not be raised above elevation 4143.2 and shall not be lowered below elevation 4137, except at such time, and on such conditions, as may be satisfactory to the Contracting Officer: *Provided*, That the Contracting Officer [for Reclamation] from time to time may specify a higher

> minimum elevation than 4137 if in his opinion such must be maintained in order to protect the irrigation and reclamation requirements of Project land. Whenever the elevation of the lake drops to a point two-tenths of a foot above the applicable minimum elevation, the Contracting Officer may assume control of the Link River Dam and its outlets and continue in control so long as the lake level remains at or below that elevation." (SER-84-85 (emphasis in original).)

The 1956 Contract also expressly recognizes and preserves Reclamation's rights to Klamath River water. Thus Article 6 of the 1956 Contract provides in pertinent part that

> "[n]othing in this agreement shall curtail or in anyway be constructed as curtailing the rights of the United States to Klamath Water or to the lands along or under the margin of Upper Klamath Lake. No Klamath Water shall be used by Copco when it may be needed or required by the United States or any irrigation or drainage district, person, or association obtaining water from the United States for use for domestic, municipal, and irrigation purposes on Project Land: *Provided*, That nothing in this agreement shall curtail or interfere with the water rights of Copco having a priority earlier than May 19, 1905 * * *." (SER-85-86 (emphasis in original).)

The text of Article 6 was first drafted as a 1920 amendment to Article 10 of the 1917 contract. (Craig Decl, Ex 3; SER-108-10.) Adopted in response to local concerns that the United States had given up its water rights in entering the 1917 contract, the amendment's purpose was to placate those concerns without changing the meaning of the original contract. (Craig Decl, Exs 3-5;

SER-108-12.) As such, it embodied an exchange of assurances between Reclamation and Copco that the contract does not modify or alter either party's preexisting water rights. (Craig Decl, Ex 5; SER-112.) This provision was renewed in essentially identical form as Article 6 of the 1956 Contract. (SER-85-86.)

The subsequent history of unsuccessful attempts to modify the language in negotiations leading up to the 1956 Contract demonstrates that Reclamation intended to retain authority over the Link River Dam to meet fish and wildlife needs. On October 21, 1954, Copco's attorney sent Reclamation a letter proposing to modify the language that would become Article 6 in the 1956 Contract. (*See* 12/8/97 Declaration of Stephen M. Macfarlane in Opposition to Plaintiffs' Motion for Summary Judgment ("Macfarlane Decl"), Ex 5; CR 187; SER-72-75.) The attorney offered several compromise paragraphs. The first proposed paragraph states:

> "1. That none of the waters of Upper Klamath Lake or its tributaries or those of the Klamath River shall be used by the company for any other purpose *when the same may be needed or required by the United States for any irrigation or drainage district, person or association obtaining water from the United States for irrigation of lands* lying within the Klamath Basin including the lands of Butte Valley and the Oklahoma lands, all of said lands being identified upon a map annexed to the agreement and approved by the parties * * *." (*Id.* at 4; SER-74 (emphasis added).)

A little over a month later, in December 1954, the Acting Regional Solicitor critiqued Copco's proposal for the Regional Director of Reclamation. (*Id.*, Ex 6 (Dec. 3, 1954 memorandum); SER-76-78.) The Acting Regional Solicitor found the language quoted directly above deficient in that it did not allow for water for "fish and wildlife purposes." (*Id.* at 2; SER-77.) The issue of needing to furnish "water for waterfowl purposes and to maintain fish in the Klamath River" was raised later in a February 3, 1955 meeting between Reclamation and Copco. (ER 343.) Copco's proposal to modify the language that became Article 6 in the 1956 Contract was rejected.

In addition to negotiating with Reclamation before entering the 1956 Contract, Copco conducted several discussions with the Project irrigators. Both Copco and Reclamation understood these discussions to be public relations efforts rather than contract negotiations. In an August 16, 1954 report to the Commissioner of Reclamation, from the Regional Director, the director recounted a meeting four days earlier with J.C. Boyle, general manager for Copco. (Craig Decl, Ex. 6; SER-113-15.) According to the Regional Director's report, Copco explicitly refused to consider the meetings with the irrigation districts as negotiations:

> "We [Reclamation] pointed out that it is our feeling that contract negotiations between Interior and Copco have been made more difficult by reason of these

> extended discussions since the water users will now feel a proprietary interest in phases of the contract outside their jurisdiction. *Mr. Boyle said the discussions had been initiated by the water users, that the company had merely responded to their request for a draft of contract, for meetings, etc., etc. He did not feel that the discussions should be properly characterized as contract negotiations."* (*Id.* at 2; SER-114 (emphasis added).)

At the time, public relations with the Project irrigators was important for Copco because the irrigators had filed a challenge to a new hydroelectric project on the Klamath River, the "Big Bend No. 2" project. (11/14/97 Declaration of Paul S. Simmons in Support of Plaintiffs' Motion for Summary Judgment on Claims Related to 1956 Contract ("Simmons Decl"), Exs. 20, 22; SER-48-50.)

The 1956 Contract is not the only agreement governing PacifiCorp's operation of the Link River Dam. PacifiCorp's hydroelectric dams on the Klamath River are also subject to the terms of a license from the Federal Energy Regulatory Commission ("FERC"). (O'Connor Decl, ¶ 5; SER-11-12.) Article 52 of the FERC license requires PacifiCorp to release a minimum of 1,300 cubic feet per second ("cfs") into the Klamath River below the Iron Gate Dam[1] during the period from September 1 to April 30 each year. (O'Connor Decl, ¶ 7, Ex 2; SER-12, 15.)

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[1] The Iron Gate Dam is the most downstream of the six Klamath River dams covered by PacifiCorp's FERC license. (O'Connor Decl, ¶ 6; SER-12.)

B. Events Giving Rise to This Litigation

In prior and less contentious times, Copco, and later PacifiCorp as successor to Copco, operated the Link River Dam with a good deal of discretion. As long as they provided water sufficient to satisfy Reclamation's then-existing needs for Project water and met the conditions in their FERC license, Copco and PacifiCorp could store and release any excess water to maximize downstream hydroelectric generation. (*Id.*, ¶ 5, ¶ 9; SER-11-12.)

In recent years, however, Reclamation has needed increasing amounts of water to meet its purposes and obligations. Increasing pressure on the water resources in the Klamath Basin has removed much of PacifiCorp's discretion. (*Id.*, ¶ 9; SER-12.) Today, the Klamath Project, including the Link River Dam, is operated to meet a multitude of water needs and legal obligations, including irrigation, endangered sucker species in Klamath Lake,[2] tribal trust

[2] The U.S. Fish and Wildlife Service (the "Service") has listed the Lost River and Shortnose sucker fish as endangered under the Endangered Species Act (the "ESA"). 16 USCA § 1531, *et seq.* (1985 & Supp 1998). In 1996, PacifiCorp and Reclamation conducted a joint consultation with the Service on the impacts of the Klamath Project (the "Project") operation on these listed species, which resulted in the issuance on July 15, 1996 of an incidental take statement containing operational restrictions on the Project. (O'Connor Decl, ¶ 10; SER-13.)

responsibilities, wildlife refuges, power generation, flood control, and flows for threatened coho salmon downstream of the Iron Gate Dam.[3] (*Id.*)

In an attempt to operate the Project to meet these competing needs, Reclamation in May 1997 released its 1997 Klamath Operating Plan (the "1997 Plan"). (Declaration of Karl E. Wirkus in Opposition to Plaintiffs' Application for a Temporary Restraining Order ("Wirkus Decl"), ¶¶ 1-3; CR 27; SER-2-3.) Reclamation indicated that the 1997 Plan addresses the multitude of competing uses in the Klamath Basin, including tribal trust, wildlife refuges, irrigated agriculture, and, under the ESA, endangered sucker fish and threatened coho salmon. (Wirkus Decl, ¶ 3; SER-2-3.)

Under the 1997 Plan, the September flows downstream of the Iron Gate Dam, PacifiCorp's furthest downstream project, would be just 1,000 cfs. (O'Connor Decl, ¶ 12; SER-13.) This level is 300 cfs below the 1,300 cfs September flow required by PacifiCorp's FERC license. (*Id.*) As a result, PacifiCorp announced that it could not implement the 1997 Plan as initially

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[3] In May 1997, the Department of Commerce through the National Marine Fisheries Service ("NMFS") listed coho salmon in the southern Oregon and northern California coastal area. 62 Fed Reg 24,588 (May 6, 1997). This ESA designation includes coho salmon downstream from the Iron Gate Dam. Both the suckers in Upper Klamath Lake and the anadromous species in the Klamath River require sufficient water to survive, which means that it is becoming increasingly important to balance the various uses of water in the Klamath Basin.

proposed. (*Id.*, ¶ 13; SER-13-14.) When PacifiCorp later learned that Reclamation's figure (1,000 cfs) was based on its informal consultation with the National Marine Fisheries Service ("NMFS") and affected Indian tribes, and upon further analysis of its obligations under the FERC license,[4] PacifiCorp concluded that it could legally implement the 1997 Plan. (O'Connor Decl, ¶¶ 14-16; SER-14.)

In order to clarify for FERC that implementing the 1000 cfs flow in the 1997 plan was authorized under Article 52 of the FERC license, PacifiCorp and Reclamation agreed to a short-term modification to the 1956 Contract. (11/14/97 Declaration of Randy Landolt in Support of PacifiCorp's Motion for Summary Judgment ("Landolt Decl"), ¶¶ 7-8; CR 167; SER-61; O'Connor Decl, ¶ 16; SER-14.) Effective June 3, 1997, PacifiCorp signed an agreement with Reclamation modifying the 1956 Contract. (*Id.*, Ex 5; SER-24-25.) The contract modification expressly states that PacifiCorp is operating the Link River Dam at the direction of Reclamation to implement its 1997 Plan.

The next day, on June 4, 1997, plaintiffs filed suit in district court. (ER-607.)

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[4] Article 52 of the license authorizes deviation from license terms (such as the 1,300 cubic feet per second requirement) for conditions beyond the licensee's control. (O'Connor Decl, Ex. 2; SER-15.)

V. SUMMARY OF ARGUMENT

The district court properly granted summary judgment to PacifiCorp declaring that plaintiffs are not third-party beneficiaries under the 1956 Contract. Through their third-party beneficiary argument, plaintiffs sought to expand PacifiCorp's status under the Contract from the operator of Reclamation's dam to a guarantor of plaintiffs' supply of irrigation water, at a time when decisions by Reclamation, not PacifiCorp, threaten that supply. Plaintiffs' contractual rights to irrigation water are governed by their water supply contracts with Reclamation, not by the 1956 Contract.

The language of the 1956 Contract does not support plaintiffs' position. To the contrary, the plain language of the Contract reveals no express or implied intention by the parties to the Contract, PacifiCorp and Reclamation, that plaintiffs be granted party status with powers of enforcement. Although plaintiffs, as well as other users of water within the Klamath Project, indirectly benefit from PacifiCorp's obligation to Reclamation to operate the Link River Dam, that does not give plaintiffs rights of enforcement under the Contract.

The district court also properly denied plaintiffs' motion to dismiss PacifiCorp's amended counterclaim and granted the requested declaration, that PacifiCorp is not liable to plaintiffs under the 1956 Contract for implementing Reclamation's Project operations decisions made pursuant to federal obligations

like the ESA and tribal trust duty. Plaintiffs' position is based on the erroneous contention that in entering the 1956 Contract Reclamation "privatized" the Link River Dam and divested itself of the ability to control the Dam as necessary to meet its legal obligations. The fact is, however, the Link River Dam is owned by Reclamation and is part of a federal reclamation project under Reclamation's management. Plaintiffs themselves recognized this by challenging the 1997 Plan for the Klamath Project as a "major federal action" under NEPA, but now they seem to want to reap the benefits of participating in a federal project without bearing any of the regulatory burdens.

Further, in the 1956 Contract--entered into pursuant to "acts of Congress relating to the preservation and development of fish and wildlife resources"—Reclamation reserved overall authority over decisions regarding use of Project water for fish and wildlife purposes such as those served by the Endangered Species Act. In fact, the 1956 Contract did nothing at all to alter the balance between Reclamation's needs for fish and wildlife on the one hand and for Project irrigators on the other. Thus, whatever argument the plaintiffs may have with the way Reclamation has struck that balance, under the Endangered Species Act or otherwise, the 1956 Contract does not provide them with a basis for challenging those decisions. Nor could it, in any case, as it does not contain any clear surrender of the United States' sovereign power to enact

legislation, like the Endangered Species Act, regarding or impacting the subject of the contract.

VI. THE DISTRICT COURT PROPERLY GRANTED SUMMARY JUDGMENT

Plaintiffs argue that the district court erred both in denying Plaintiffs' Motion for Summary Judgment and in granting Defendants' Motions for Summary Judgment. Plaintiffs' argument on both these points rests wholly on their claim to be third-party beneficiaries of the 1956 Contract between Copco and Reclamation. Because plaintiffs, as a matter of law, are not third-party beneficiaries entitled to enforce the 1956 Contract, the district court did not err in denying summary judgment to plaintiffs and granting summary judgment in favor of defendants.

A. On a Summary Judgment Motion, Contractual Intent Must Be Construed in Light of What a Reasonable Person Reading the Words Would Believe Was Intended by the Parties

Plaintiffs' formulation of the standard of review does not address the standards governing interpretation of contract language in the context of summary judgment. While the summary judgment context requires that plaintiffs' factual allegation be construed in a light most favorable to plaintiffs, "[t]he crucial question [remains] 'what [the contractor] would have understood as a reasonable * * * contractor,' not what the drafter of the contract terms

subjectively intended." *Corbetta Construction Company v. United States*, 461 F2d 1330, 1336 (Ct Cl 1972) (citations omitted). "[T]he language of a contract must be given that meaning that would be derived from the contract by a reasonably intelligent person acquainted with the contemporaneous circumstances." *Hol-Gar Manufacturing Corp. v. United States*, 351 F2d 972, 975 (Ct Cl 1965).

"Generally, the plain language of a contract controls, and only language which is reasonably susceptible to more than one meaning may be considered ambiguous." *Thermal Electronic, Inc. v. U.S.*, 25 Cl Ct 671, 673 (1992) (citing *Neal & Co. v. United States*, 19 Cl Ct 463, 471 & n 4 (1990), *aff'd* 945 F2d 385 (Fed Cir 1991); *John C. Grimberg Co., Inc. v. United States*, 7 Cl Ct 452, 457, *aff'd* 785 F2d 325 (Fed Cir 1985)). An ambiguity does not exist simply on the basis that the parties assert different interpretations of the contract. *Thermal Electronic*, 25 Cl Ct at 673. While "[a]ny group of words can be twisted by strained construction into an ambiguity * * * this should not be done." *Dana Corporation v. United States*, 470 F2d 1032, 1043 (Ct Cl 1972) (citing *Aero Mayflower Transit Co. v. United States*, 162 Ct Cl 233, 237 (1963)). "'When parties have deliberately put their engagements in writing, and such writing is complete on its face and is certain and definite as to the objects of their engagement, it is conclusively presumed that the whole contract

of the parties and the extent and manner of their undertaking was reduced to writing, and cannot be contradicted, altered, added to or varied by parol or extrinsic evidence.'" *National Rural Util. Co-op. Finance Corp. v. U.S.*, 14 Cl Ct 130, 136 (1988), *aff'd* 867 F2d 1393 (Fed Cir 1989) (quoting Walter H.E. Jaeger, 4 *Williston on Contracts* § 632A at 985 (3d ed 1961)).

B. Only Intended Beneficiaries May Enforce Contractual Promises

Plaintiffs are not parties to the 1956 Contract and therefore have no right of enforcement unless they qualify as third-party beneficiaries. *Berberich v. United States*, 5 Cl Ct 652, 655 (1984), *aff'd* 770 F2d 179 (Fed Cir 1985). Third-party beneficiary status is an exception to the strong presumption that a contract only benefits the parties thereto; consequently, an ostensible third-party beneficiary must meet an onerous challenge: "Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement to which he is not a party, he must, at least, show that it was *intended for his direct benefit*." *German Alliance Ins. Co. v. Home Water Supply Co.*, 226 US 220, 230, 33 S Ct 32, 57 L Ed 195 (1912) (emphasis added).

The issue of intent to confer a *direct* benefit is crucial. To permit a plaintiff to sue as a third-party beneficiary, the intent to provide a direct, legally enforceable benefit must always exist; it is not enough that the parties knew, or even desired, that a third party would benefit from their contract. *See*

Hairston v. Pacific 10 Conference, 101 F3d 1315, 1320 (9th Cir 1996) (founders of Pac 10 were aware conference would benefit student athletes, but did not intend "to create direct legal obligations between themselves and the students"); *Montana Bank of Circle v. United States,* 7 Cl Ct 601, 611 (1985) (absent intent to assume direct obligation of third party, it is not enough that parties had "a desire or purpose to confer a benefit on a third person, nor a desire to advance his interests"). Incidental beneficiaries, such as appellants, are benefitted by performance of a contractual promise but do not acquire by virtue of the promise any right against the promisor or promisee. Restatement (Second) of Contracts § 315 (1981).[5]

In many cases the structure of contractual performance provides the "critical indicum of intent" to provide a direct, enforceable benefit to a third party. *Public Service Co. of N.H. v. Hudson Light & Power,* 938 F2d 338, 342 (1st Cir 1991). Unless the contract requires performance that directly benefits the would-be beneficiary, such as requiring direct payments to the beneficiary, the beneficiary is at best an incidental beneficiary. *See id.* The showing of intent to provide a direct benefit must be made with "special

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[5] As plaintiffs correctly observe (App Br at 27 n 8), federal courts may look to general principles of contract law, such as the Restatement, when developing federal common law. *See Kennewick Irr. Dist. v. U.S.,* 880 F2d 1018, 1031 (9th Cir 1989).

clarity," *McCarthy v. Azure*, 22 F3d 351, 362 (1st Cir 1994), although the intent may be express or implied. *Carlow v. U.S.*, 40 Fed Cl 773, 781 (1998); *Schuerman v. U.S.*, 30 Fed Cl 420, 433 (1994).

In the case of government contracts for the provision of public services, the burden on a putative third-party beneficiary who seeks to enforce the contract against a nongovernment promisor is even more daunting. In these cases, members of the public whom the contract benefits are considered to be incidental beneficiaries unless they can show that the contract gives them a direct right of enforcement or compensation. *State of Mont. v. U.S.*, 124 F3d 1269, 1273 n 6 (Fed Cir 1997); *Schuerman*, 30 Fed Cl at 430; Restatement (Second) of Contracts § 313 (1981). While appellants are not third-party beneficiaries of the 1956 Contract in any event, this special rule confirms that the 1956 Contract does not confer on appellants any direct right of enforcement or compensation.

C. Plaintiffs Are Not Intended Beneficiaries of the 1956 Contract

1. The 1956 Contract Does Not Designate Plaintiffs as Intended Beneficiaries with Respect to Water Rights

The first and most reliable place to look for the intent of parties to a contract is the express language of the contract itself. *Samsung Electronics America, Inc. v. U.S.*, 106 F3d 376, 379 (Fed Cir 1997) (intent of parties as

evidenced by written instruments forming contract is of "primary concern"); *Aleman Food Services, Inc. v. U.S.*, 994 F2d 819, 822 (Fed Cir 1993) (same). A likely reason for plaintiffs' cursory treatment of this crucial element of a third-party beneficiary claim is that the contractual language expresses no intent to confer direct benefits on appellants with respect to water rights.

a. Plaintiffs are not among the beneficiaries expressly identified under the 1956 Contract.

The parties to the 1956 Contract clearly expressed their intent as to the identity of contract beneficiaries:

> "15. This contract binds and inures to the benefit of the parties hereto, their successors and assigns, including without limitation any water users' organization or similar group which may succeed either by assignment or by operation of law to the rights of the United States hereunder." (SER-89.)

This provision expressly limits contract beneficiaries with enforceable rights to the parties (Copco and Reclamation) and their successors and assigns. The parties expressed their intent, in the clearest terms possible, to provide an enforceable benefit to water users, such as appellants, only in cases where they have succeeded to the rights of the United States.

Plaintiffs erect, then knock down, a straw man in arguing that the rights of assignees are distinct from the rights of third-party beneficiaries. PacifiCorp agrees that in the abstract "no assignment is required to create third party

beneficiary rights." (App Br at 47.) What plaintiffs ignore, however, is that the parties' use here of an express "successors and assigns" clause evidences that the parties fully understood how to create rights in persons beyond the immediate parties to the agreement when it was their intention to create such rights. The presence of an express "successors and assigns" clause, coupled with the complete absence of an express third-party beneficiary designation naming plaintiffs, evidences that there was no intention to make plaintiffs third-party beneficiaries with respect to irrigation water.

Plaintiffs also argue that if they "are not third party beneficiaries, it would be impossible to create third party beneficiaries under the 1956 contract." (*Id.* at 44.) Nonsense. First, the 1956 Contract already identifies those intended to be benefitted through its successors and assigns clause. Second, the parties to the 1956 Contract could in the future modify it to add specified beneficiaries if they desired. Third, if the 1956 Contract had expressly declared plaintiffs to be third-party beneficiaries, they would be so. There would be nothing "illogical" about that result. Such an express statement would simply evidence an objective intention that differs from the objective intention evidenced by the absence of an express statement. If the words differed, so too would the intentions they evidence.

The failure of the contracting parties to designate plaintiffs as express third-party beneficiaries with respect to irrigation water is particularly significant in this case because the parties knew how to express an intent to confer a direct benefit on third parties. In Article 5 of the 1956 Contract, Copco agrees to provide electric power to project irrigators (a discrete, identifiable group) at an on-peak rate of 5 mils per kwh. (SER-85.) This promise confers on third parties an intentional, direct, and specifically identifiable benefit: the right to electric power at a rate better than the preexisting market rate. The 1956 Contract contains no similar promise with respect to water: Reclamation is the direct beneficiary of PacifiCorp's promise to operate the dam, not plaintiffs. The logical interpretation of these facts is that given Copco's promise with respect to power rates and the absence of any such promise with respect to water, Copco and Reclamation did not intend to grant third-party rights to irrigation water at all.[6]

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[6] A party may be a third-party beneficiary of one provision of a contract but not another. *See* John D. Calamari & Joseph M. Perillo, *The Law of Contracts* § 17-3 (3d ed 1987) ("It is important to observe that it is possible that in a contract where the promisor makes a number of promises, the third party may be the beneficiary of one promise but not of another."); *Sumner Peck Ranch, Inc. v. Bureau of Reclamation*, 823 F Supp 715, 732-33 (ED Cal 1993) (whether party is third-party beneficiary of some but not all provisions of contract is function of parties' intent and can be determined from contractual language).

Plaintiffs do not allege that the United States has assigned its rights under the 1956 Contract to them or that they have succeeded to those rights by operation of law. Therefore, with regard to operation of the Link River Dam, the 1956 Contract unambiguously expresses an intent to provide a direct, enforceable benefit only to Copco and Reclamation, not to plaintiffs. Plaintiffs' efforts to read an implied benefit to themselves of irrigation water rights or control of the Link River Dam into the 1956 Contract notwithstanding, a court may not add an implied contract term that is inconsistent with express contractual language. *Tennessee Valley Authority v. Exxon Nuclear Co.*, 753 F2d 493, 497 (6th Cir 1985) (where contract clearly expressed which parties were to be bound, court not permitted to add implied term requiring government agency to compensate third party).

b. Reference to "users of water" is only a recital, not a promise.

Despite the clear expression of the parties' intent *not* to grant plaintiffs a direct benefit, plaintiffs argue that the parties' intent to benefit is expressed in the recitals of the 1956 Contract, in which the parties state that their execution of a new contract is "to their advantage and to the best interests of the users of water in the Upper Klamath River Basin * * *." (SER-83.) This recital does not identify plaintiffs individually or as a class except as a subset of all "users

of water" within a large geographical area. The term "users of water" presumably includes every inhabitant of or visitor to the region, and cannot reasonably be construed as expressing an intent to benefit plaintiffs directly. Any different construction of this recital would result in every user of water being considered a third-party beneficiary of the provision.

Furthermore, contractual recitals such as this one are not the equivalent of contractual promises. *See KMS Fusion Inc. v. U.S.*, 36 Fed Cl 68, 77 (1996), *aff'd* 108 F3d 1393 (Fed Cir 1997) (distinguishing between recitals and operative contract provisions); *Abraham Zion Corp. v. Lebow*, 761 F2d 93, 103-04 (2d Cir 1985) (recital "'cannot create any right beyond those arising from the operative terms of the document'" (citation omitted)); *In re Pyramid Operating Authority, Inc.*, 144 BR 795, 814 (Bankr WD Tenn 1992) (recital explains existing circumstances surrounding execution of contract but does not create binding obligation). Even if this provision were located in the main body of the 1956 Contract, it would not constitute a concrete promise; at best, it is a statement of the hoped-for effect of Copco's operation of the Link River Dam. *See Hairston*, 101 F3d at 1320 ("'vague, hortatory pronouncements'" about benefits to student athletes insufficient to render them third-party beneficiaries of contract between intercollegiate athletic association and its members (citation omitted)). The mere reference to "users of water" in a recital to the 1956

Contract simply does not establish that the parties intended to confer direct benefits on plaintiffs.

2. The Contract Evinces No Intent To Grant Plaintiffs a Direct Right of Enforcement

Where, as here, a government entity contracts with a nongovernment promisor[7] (such as Copco) for the provision of a public service, public beneficiaries (such as plaintiffs) who seek to enforce a right against the promisor must show that the contract gives them a direct right of enforcement or compensation. *See State of Montana*, 124 F3d at 1273 n 6 ("when members of the public bring suit against promisors who contract with the government to render a public service * * * [they] are considered to be incidental beneficiaries unless they can show a direct right to compensation"); *Schuerman*, 30 Fed Cl at 429 (requiring for purposes of "general government contracts" that there be "direct evidence in the contract that the contracting parties intended to give the third party an enforceable right to sue [for compensation]"); Restatement

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[7] As in virtually all contracts, promises in the 1956 Contract flow in both directions. However, with respect to its maintenance of the level of Klamath Lake, PacifiCorp is the promisor. Therefore, this discussion refers to PacifiCorp as the promisor, even though, strictly speaking, PacifiCorp is both a promisee and a promisor in terms of the contract as a whole.

(Second) of Contracts § 313.[8] This rule, while not crucial to PacifiCorp's argument, provides an additional (or alternative) basis for concluding that appellants are not third-party beneficiaries of the 1956 Contract.

The requirement that putative third-party beneficiaries of government contracts show a direct right of enforcement was set out in *Baudier Marine Electronics v. United States*, 6 Cl Ct 246, 249 (1984), *aff'd* 765 F2d 163 (Fed Cir 1985) (requiring all third-party beneficiaries to show both intent to benefit

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[8] Restatement (Second) of Contracts § 313(2) (1981) provides:

> "[A] promisor who contracts with a government or governmental agency to do an act for or render a service to the public is not subject to contractual liability to a member of the public for consequential damages resulting from performance or failure to perform unless
>
> "(a) the terms of the promise provide for such liability; or
>
> "(b) the promisee is subject to liability to the members of the public for the damages and a direct action against the promisor is consistent with the terms of the contract and with the policy of the law authorizing the contract and prescribing remedies for its breach."

Clearly, the terms of the 1956 Contract do not provide for such liability. Moreover, the promisee (in this case, Reclamation) is affirmatively *exempted* from liability to project irrigators for failure to provide water in the vast majority of cases. (4/27/98 Order at 4; ER-568.)

and intent to give direct right of enforcement or compensation). Later decisions limited the application of the second prong of *Baudier* to cases involving promisors who contract with the government to render a public service. *See Schuerman*, 30 Fed Cl at 430; *State of Montana*, 124 F3d at 1273 n 6. Because Copco contracted with Reclamation in part to render a public service, and because that public service is at issue in this case, plaintiffs cannot succeed unless they show that the 1956 Contract gives them a direct right of enforcement or compensation.

The 1956 Contract, at least as it affects plaintiffs, is clearly a contract for the provision of a public service—operation of the Link River Dam for the impoundment and provision of water for irrigation and other purposes. The Project is a project of the federal government, the purpose of which is to provide this public service. Therefore, plaintiffs must show that Copco and Reclamation intended to grant plaintiffs a direct right of enforcement. Plaintiffs have not done so. Instead, they call this rule "troubling," and observe that courts have permitted third-party beneficiaries to enforce government contracts upon a showing of intent to benefit where the government was the promisor. (App Br at 44 n 14.) Tellingly, plaintiffs admit that here the government is "merely the promisee." (*Id.*)

Plaintiffs betray a fundamental misunderstanding of the rationale behind the requirement that would-be third-party beneficiaries of government contracts show that the contracting parties intended to allow a direct right of enforcement. The requirement protects *nongovernmental* promisors such as Copco from unintended and potentially ruinous liability to third parties: "Because government contracts often benefit a large number of persons, if third party beneficiaries can enforce such contracts against the private actor, the result may be the imposition of liability well out of proportion to the benefits the private actor stood to receive under the contract." Melvin A. Eisenberg, "Third Party Beneficiaries," 92 Colum L Rev 1358, 1407 (1992); *see also H. R. Moch Co. v. Rensselaer Water Co.*, 247 NY 160, 159 NE 896, 897-98 (1928) (nongovernmental promisor's "intention to assume an obligation of indefinite extension" seems improbable in light of "the crushing burden that the obligation would impose").[9]

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[9] The cases plaintiffs cite in which the *government* is the promisor are therefore wholly inapposite. Even in these cases, however, courts have required a clearer showing of intent than plaintiffs are able to make in this litigation. In *D & H Distributing Co. v. U.S.*, 102 F3d 542, 545-47 (Fed Cir 1996), a party was entitled to enforce a contract modification only because the modification expressly made the party a joint payee of contract proceeds. In *Schuerman v. U.S.*, the defendant admitted in the pleadings that the contract was "for the specific benefit of plaintiffs and no one else." 30 Fed Cl 420, 433 (1994). In *H.F. Allen Orchards v. United States*, 749 F2d 1571 (Fed Cir

(continued...)

In this case, the contract evinces no express or implied intent to grant irrigators, such as plaintiffs, a direct right to enforce the terms of the 1956 Contract. PacifiCorp is clearly not a governmental entity and, as plaintiffs admit, PacifiCorp is the contractual promisor. (App Br at 44 n 14.) Therefore, because plaintiffs have presented no evidence that the 1956 Contract grants them a direct right of enforcement, as a matter of law they cannot be third-party beneficiaries of the 1956 Contract with a right of enforcement (at least with respect to irrigation water). Although the district court's decision apparently did not rely on the 1956 Contract's omission of a direct right of

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[9] (...continued)
1984), the court granted summary judgment for the government on the basis that the government did not have the obligation alleged, although the court noted that irrigators were third-party beneficiaries of a consent decree between the government and an irrigation district regarding the standard allotment and precise procedure for allocation of water. In each of these cases, unlike in this case, the intent to provide a direct benefit to the alleged third-party beneficiary was obvious.

In the other three cases cited by plaintiffs, the government had obligated itself to make payments of money that were intended for the direct benefit of third parties. *See Holbrook v. Pitt*, 643 F2d 1261, 1271 (7th Cir 1981) (HUD made housing assistance payments on behalf of low-income tenants); *Carlow v. U.S.*, 40 Fed Cl 773, 781-83 (1998) (upon retrocession agreement, United States took on obligations of Indian tribe to pay contractor); *Busby School of Northern Cheyenne Tribe v. U.S.*, 8 Cl Ct 596 (1985) (government obligated to pay for repair and maintenance of high school facility). None of these cases bear any substantive resemblance to the case at issue in this appeal, which does not involve a direct financial obligation.

enforcement, this omission provides further support for the district court's judgment.

3. No Intent To Grant Plaintiffs a Direct Benefit Can Be Implied from the Terms of the 1956 Contract

It is not disputed that plaintiffs and other irrigators derive some benefit from performance of the 1956 Contract. However, to establish status as a third-party beneficiary, "a plaintiff must show more than that the contracting parties acted against a backdrop of knowledge that the plaintiff would derive benefit from the agreement." *Corrugated Paper Products v. Longview Fibre Co.*, 868 F2d 908, 912 (7th Cir 1989). In claiming rights as third-party beneficiaries of the 1956 Contract, plaintiffs fail to distinguish between intended beneficiaries and incidental beneficiaries of a contract. *See* Restatement (Second) of Contracts § 315 (incidental beneficiaries benefit from performance of contractual promise but do not acquire by virtue of promise any right against promisor or promisee). At best, plaintiffs show that the parties to the 1956 Contract knew that performance would benefit, inter alia, irrigators such as plaintiffs. However, the contractual language does not support plaintiffs' argument that they are, by implication, direct intended beneficiaries of the 1956 Contract. Therefore, plaintiffs cannot be third-party beneficiaries of the 1956 Contract with respect to irrigation water.

a. The requisite intent to benefit cannot be implied from the contractual language.

Plaintiffs argue that they are third-party beneficiaries of two articles of the 1956 Contract that, according to plaintiffs, "contain terms to benefit irrigation water users." (App Br at 28.) Specifically, plaintiffs point to Article 2 and Article 6 of the 1956 Contract as evincing an intent to confer a benefit on project irrigators.

Article 2 provides that Copco (now PacifiCorp) is to operate the Link River Dam for 50 years and must maintain the lake elevation within prescribed limits; if the water level falls too low, Reclamation may take control of the dam. (SER-84-85.) While this provision may indirectly result in a benefit to protect irrigators to the extent that PacifiCorp is not permitted to drain the lake dry, as a matter of law it does not evidence an intent to confer a direct benefit or the right of enforcement on plaintiffs. Indeed, by its terms, Article 2 grants *Reclamation*, not plaintiffs, the right to enforce the contract by taking control of the dam.

Article 6 of the 1956 Contract provides:

> "No Klamath water shall be used by Copco when it may be needed or required by the United States or any irrigation or drainage district, person, or association obtaining water from the United States for use in domestic, municipal, and irrigation purposes * * *." (SER-86.)

By its terms, this provision protects persons "taking water from the United States" and allows the United States to meet its obligations to those individuals. Plaintiffs claim that "Article 6 specifically identifies named plaintiffs in that they are a 'drainage district' (KDD) and 'person' (Henzel) that obtain Klamath water for irrigation purposes on Project Land." (App Br at 30-31.) However, plaintiffs ignore the crucial modifier "from the United States."

Plaintiffs' rights to irrigation water derive from their water supply contracts with Reclamation. Article 6 merely recognizes Reclamation's obligations to irrigators, inter alia, and confirms that the grant of rights to Copco is made subject to these obligations. The promise in Article 6 does not confer any new or additional rights on irrigators, but is intended to run directly to Reclamation and to preserve Reclamation's ability to fulfill its contractual obligations. As a matter of law, contract provisions preventing interference with existing rights, such as Article 6, do not turn the holders of such rights into third-party beneficiaries. *Norse v. Henry Holt and Co.*, 991 F2d 563 (9th Cir 1993).

In challenging *Norse*, plaintiffs attribute to *Norse* a holding that *Norse* did not announce and that PacifiCorp and the government did not attribute to *Norse*. This court did not hold in *Norse* that the existence of a preexisting right in a party claiming to be a third-party beneficiary is, in and of itself, fatal to

that party also being able to enforce such a right as a third-party beneficiary of a contract. What *Norse* instead shows is that where a right already exists in a party who also claims to be a third-party beneficiary, mere acknowledgment of that independent right in the contract does not establish objective intent by the parties that this independent right also becomes enforceable by the third party as a right under the contract. If the parties to a contract wished to do so, they could add to a third party's existing independent rights an additional power allowing those existing rights also to be enforced by the third party as rights under the contract. Where, however, all the contract does is acknowledge the existence of preexisting rights, a reasonable person would not and could not conclude from the mere recital that the parties were intending to bestow on the third party the power to enforce his or her existing right through the contract.

Plaintiffs also argue that a plain reading of Article 6 as recognizing preexisting rights somehow makes Article 6 "irrelevant" and would permit PacifiCorp to "completely empty the reservoir, with no accountability whatsoever." (App Br at 45.) This conclusion has no basis in fact or in the contractual language. Instead, Article 6 makes clear that PacifiCorp could *not* release water if doing so would interfere with the obligations of the United States (including, but not limited to, the provision of irrigation water). No

intent to provide a direct, enforceable benefit to the users of irrigation water can be implied from the contractual language.

In addition, because the clause refers to users of water for "domestic, municipal, and irrigation purposes"—in essence, the entire population of the Klamath Basin—insofar as these individuals take water from the United States, this provision strengthens the conclusion that the 1956 Contract is a contract for the provision of public services. As discussed in section VI.C.2, *supra*, there is no evidence that the parties intended to grant plaintiffs, let alone all domestic, municipal, and irrigation water users in the area, the direct right to enforce the 1956 Contract. Certainly no such right is expressed in or can be implied from this provision.

Finally, the 1956 Contract does nothing to alter the underlying balance of rights between the irrigators and Reclamation's other federal responsibilities. The 1956 Contract clearly distinguishes between the needs of the United States, through Reclamation, and the needs of the Project irrigators. The 1956 Contract makes Copco's rights (except for its pre-1905 rights) subordinate to *both* sets of needs—those of Reclamation and those of irrigators. The contract does not, however, modify or even address the underlying legal principles relevant to balancing those potentially competing needs.

A dispute between the Project irrigators and Reclamation over Reclamation's water allocation decisions certainly implicates the irrigators' underlying water supply contracts. *See O'Neill v. U.S.*, 50 F3d 677 (9th Cir), *cert den* 516 US 1028 (1995). Such a dispute may also implicate principles of administrative law and, perhaps, of environmental review under statutes such as the National Environmental Policy Act ("NEPA"). It does not, however, implicate the 1956 Contract. While PacifiCorp's operation of the Link River Dam under that contract may assist Reclamation in meeting its various obligations, the 1956 Contract itself says nothing about the prioritization among them.[10] Thus the 1956 Contract presents no basis upon which the Project irrigators may challenge Reclamation's water allocation decisions.

b. The structure of the 1956 Contract demonstrates that the parties did not intend to grant plaintiffs a direct benefit.

The structure of contractual performance can be an important element in determining of whether a third party is an intended beneficiary of a contract. *Public Service Co. of N.H.*, 938 F2d at 342 (structure provides "critical indicum of intent"). In this case, the structure of contractual performance

[10] Nor does the 1956 Contract require PacifiCorp to defend irrigators if Reclamation decides water must be released to meet other needs.

demonstrates that the parties did not intend to allow plaintiffs a right of enforcement or compensation.

The 1956 Contract is not a water supply contract, and neither confers new or additional water rights on plaintiffs nor imposes on Copco an obligation to deliver water to plaintiffs. Instead, as discussed above, the contracts governing plaintiffs' rights to irrigation water are their water supply contracts with Reclamation. The existence of these water supply contracts, combined with the 1956 Contract's lack of language creating a direct obligation flowing from Copco to Klamath irrigators, evidence a structure of contractual performance that is not intended to allow plaintiffs a direct right of enforcement of the 1956 Contract with respect to water rights. The resulting implication is that plaintiffs are not intended third-party beneficiaries of the 1956 Contract.

Plaintiffs argue strenuously that the existence of separate contracts between Reclamation and Project irrigators is irrelevant and does not preclude plaintiffs from being third-party beneficiaries of the 1956 Contract. (App Br at 37-46.) Plaintiffs' lengthy treatment of this issue is peculiar because PacifiCorp does not argue that the existence of these water supply contracts per se precludes plaintiffs from being third-party beneficiaries. Indeed, PacifiCorp maintains that the text within the four corners of the 1956 Contract is the

crucial element for the determination of plaintiffs' alleged third-party beneficiary status.[11]

However, the existence of these water supply contracts is relevant for two reasons. First, as explained above, it establishes that plaintiffs' water rights derive from sources other than the 1956 Contract and strongly implies that plaintiffs are not third-party beneficiaries of the contract. Second, as the district court observed, the vast majority of these water supply contracts contain "hold harmless" provisions exempting the government from liability for damages in the event of a water shortage. The limitations on liability in these contracts may explain why plaintiffs do not merely sue Reclamation for performance under their water supply contracts but instead look to PacifiCorp, a party with which plaintiffs are not in privity, to deliver a performance that it is not obligated to perform.[12]

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[11] This position contrasts with that of plaintiffs, who call these contracts and their terms irrelevant while at the same time largely relying on statements, superseded documents, and other extrinsic information (essentially everything *other than* their water supply contracts) dating back almost to the turn of the century.

[12] To the extent that their water supply contracts do *not* contain a "hold harmless" clause, plaintiffs should look to Reclamation, not to PacifiCorp, to deliver under those contracts.

Finally, plaintiffs' argument that they are intended beneficiaries of the contract with respect to water rights becomes even more attenuated when one considers the relatively minor consideration Copco received in return for its promise. Copco received the right to regulate the level of Klamath Lake within certain parameters and subject to Reclamation's preexisting obligations to irrigators, tribes, wildlife, and other water users. Plaintiffs' argument that Copco thereby directly obligated itself to provide sufficient water to all these water users in the Klamath Lake area, or pay damages for its failure to do so, defies logic. Such a suggestion comports with neither logic nor sound public policy, and the structure of contractual performance militates strongly against this conclusion.

c. The circumstances surrounding the making of the 1956 Contract do not support plaintiffs' arguments.

Plaintiffs urge the court to "look beyond the contract to determine and confirm the parties' intention to benefit third parties." (App Br at 31.) The only case plaintiffs cite in support of this exhortation, *Sepulveda v. Pacific Maritime Ass'n*, 878 F2d 1137 (9th Cir 1989) (applying California law), permits, but does not *require*, a court to look beyond contractual language. *See id.* at 1139 (court "may look to evidence outside the four corners of the

document").[13] However, *Sepulveda* makes clear that even if a court looks beyond the contract to determine intent, the intent must nonetheless be evident in the terms of the contract itself. *Id.* Where, as here, clear contractual language reveals the intent of the parties, an inquiry into the contract's surrounding circumstances is inappropriate. *Textron Defense Systems v. Widnall*, 143 F3d 1465, 1469 (Fed Cir 1998) (where contract language is sufficiently clear, court's inquiry is at end); *Tennessee Valley Authority*, 753 F2d at 496-97 (same). Therefore, the district court quite correctly limited its consideration of extracontractual circumstances.

To the extent that a court is permitted to examine events and circumstances beyond the four corners of the 1956 Contract, those events and circumstances establish as a matter of law that plaintiffs are not third-party beneficiaries of the contract. As the U.S. Supreme Court has itself explained, "'[w]ords and other conduct are interpreted in the light of all the circumstances * * *.'" *U.S. v. Winstar Corp.*, 518 US 839, 863, 116 S Ct 2432, 135 L Ed

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[13] Plaintiffs also cite to Arthur L. Corbin, 4 *Corbin on Contracts* § 776 at 19 (Supp 1998). (App Br at 6.) Corbin merely states that "the usual processes of interpretation should be followed." Corbin, *supra*, § 776 at 19. In other words, if contract language is ambiguous, then a court may examine the circumstances surrounding the making of the contract. Because the 1956 Contract is not ambiguous, there is no need to turn to an examination of surrounding circumstances.

2d 964 (1996) (citation omitted); *accord* Restatement (Second) of Contracts § 202(1) (1981). This principle applies in summary judgment proceedings. In granting summary judgment to the government in a contract case, the Court of Federal Claims explained, "The court * * * may use certain extrinsic evidence for the limited purpose of explaining the circumstances affecting a contract by shedding light on the parties' objective intent." *City of Tacoma v. U.S.*, 38 Fed Cl 582, 589 (1997).

Here, the existence of the water supply contracts was a circumstance known to the parties at the time the 1956 Contract was executed. It also is relevant to interpretation of the 1956 Contract that the United States is one of the parties to the agreement in its capacity as sovereign. When the United States is a party to a contract in a proprietary capacity such as buying or selling goods, its contracts are construed using the same principles of interpretation that apply between private parties. An additional principle of interpretation applies, however, when the government's role under the contract is, as it is here, principally governmental or acting as sovereign. As this very court has acknowledged, "[C]ontracts which affect the public interest are interpreted so as to favor the State * * *." *Continental Ill. Nat. Bank, etc. v. State of Wash.*, 696 F2d 692, 699 (9th Cir 1983) (recognizing principle but finding it inapplicable to facts of specific case where, in borrowing money, state was

acting in its proprietary instead of its sovereign capacity); *accord* Restatement (Second) of Contracts § 207 (1981).

Plaintiffs argue that they and their predecessors "negotiated" terms of the 1956 Contract with Copco and Reclamation before the execution of the contract. (App Br at 31-33.) It is true that Copco participated in several discussions with Project irrigators at the time, but there is no factual support for appellants' characterization of these discussions as contract negotiations. On the contrary, Copco and Reclamation understood the meetings with irrigators to be public relations efforts, not negotiations. (Craig Decl, Ex. 6; SER-113-15 (discussed at 9-10, *supra*).) Public relations with the irrigators was important for Copco because the irrigators had filed a challenge to Copco's proposed new "Big Bend No. 2" hydroelectric project. (Simmons Decl, Exs. 20, 22; SER-48-50.) And in any case, a comparison of the 1917 Contract with the 1956 Contract demonstrates that the discussions with irrigators did not lead to any changes in the 1956 Contract that plaintiffs may now claim a right to enforce (with the sole possible exception of the provisions relating to Copco's agreement to provide subsidized, low-cost electric power to Project irrigators). (Compare Craig Decl, Exs. 1 and 3; SER-82-95 and 108-10.)

Plaintiffs argue that they are third-party beneficiaries of the 1956 Contract because *they* could have reasonably concluded that the contract was

intended to benefit them. (App Br at 34.) Plaintiffs' subjective belief is irrelevant to construing the terms of the 1956 Contract. *Corbetta*, 461 F2d at 1336. Instead, the language "must be given that meaning that would be derived from the contract by a reasonably intelligent person acquainted with the contemporaneous circumstances." *Hol-Gar*, 351 F2d at 975. Given the broad context and content of the 1956 Contract, together with the contractual clause limiting the beneficiaries of the contract, plaintiffs clearly were not reasonable in concluding that they have a right to enforce the contract against PacifiCorp (if in fact appellants so concluded). Moreover, the argument eviscerates the intent-to-benefit requirement and is thus clearly wrong. *See* Arthur L. Corbin, 4 *Corbin on Contracts* § 779B (1951) (third party "cannot create in himself any rights as a beneficiary by acting in reliance on the contract or upon the performance that has been rendered between the contracting parties"). Plaintiffs cite no authority for the proposition that an incidental beneficiary of a contract may be converted into an intended beneficiary on the basis of reliance

alone.[14] While reasonable reliance may be relevant to an estoppel argument, plaintiffs made no such argument to the district court and may not do so now.

Finally, a plaintiff could in theory have rights as a third-party beneficiary under more than one promise. For this to be the case, however, the parties to the contract must have objectively intended that plaintiffs have such rights. Here, no intent to benefit in distribution of water can be inferred from the separate promise to provide electricity. Consequently, it is not that plaintiffs cannot have rights under multiple promises but that plaintiffs simply do not have such rights here.

4. The Existence of Other Rights and Obligations Is Relevant to Whether Plaintiffs Are a Third-Party Beneficiary

Finally, contractual arrangements, including those to which the sovereign is a party, "remain subject to subsequent legislation by the presiding

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[14] The one case plaintiffs cite, *Public Service Co. of N.H. v. Hudson Light & Power*, 938 F2d 338 (1st Cir 1991), does not hold that rights to enforcement may be created by reliance, but states the very different proposition that in certain cases, the requisite intent to benefit may be established if it is shown that a beneficiary would be reasonable in relying on the promise as manifesting the intent to benefit. *Id.* at 342. Furthermore, plaintiffs fail to note that this rule only applies to cases involving either a promise to pay a promisee's debt to a beneficiary or a gift promise to perform a duty of the promisee or a third party. See Restatement (Second) of Contracts § 302 cmt d (1981), which *Public Service Co.* cites for this rule. *Id.* The case at issue here fits into neither of these categories.

sovereign." *Merrion v. Jicarilla Apache Tribe*, 455 US 130, 147, 102 S Ct 894, 71 L Ed 2d 21 (1982). Moreover, "[w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs *all contracts* subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." 455 US at 148 (emphasis added). As a corollary to this, "contracts should be construed, if possible, to avoid foreclosing exercise of sovereign authority." *Bowen v. Public Agencies Opposed to Social Sec.*, 477 US 41, 52-53, 106 S Ct 2390, 91 L Ed 2d 35 (1986).

These principles apply here in deciding under the 1956 Contract whether the United States and PacifiCorp intended to create in plaintiffs direct rights of enforcement—rights that, according to plaintiffs' theory, constrain the ability of Reclamation and PacifiCorp to respond to federal laws affecting the allocation of water. As detailed above, there is not even reasonable, let alone "unmistakable," evidence that through the 1956 Contract the United States and PacifiCorp's predecessor intended at the expense of sovereign authority to vest such power in plaintiffs.

VII. THE COURT DID NOT ERR IN DENYING PLAINTIFFS' MOTION TO DISMISS PACIFICORP'S COUNTERCLAIM IN PART

A. Standard of Review

Review of a decision to grant or deny declaratory relief is de novo. *Crawford v. Lungren*, 96 F3d 380, 384 (9th Cir 1996), *cert denied*, ___ US ___, 117 S Ct 1249 (1997); *Ablang v. Reno*, 52 F3d 801, 803 (9th Cir 1995); *Tashima v. Administrative Office*, 967 F2d 1264, 1273 (9th Cir 1992); *Fireman's Fund Ins. Co. v. Ignacio*, 860 F2d 353, 354 (9th Cir 1988). "Although decision to grant or deny declaratory relief . . . is a matter initially committed to the discretion of the district court, on appeal we exercise our own 'sound discretion' to determine the propriety of the district court's grant or denial of declaratory relief. In effect, then, we review de novo the district court's ruling below." *Dexter v. Kirschner*, 984 F2d 979, 982 (9th Cir 1992) (quoting *Fireman's Fund*, 860 F2d at 354).

B. Plaintiffs Contend That Reclamation Has No Authority to Direct PacifiCorp's Operation of the Dam

In addition to assigning error to the district court's granting of PacifiCorp's motion for summary judgment, plaintiffs separately challenge the district court's denial of plaintiffs' motion to dismiss PacifiCorp's Amended Counterclaim in part. Plaintiffs' motion was directed at that portion of PacifiCorp's counterclaim that sought a declaration that PacifiCorp not be held

liable for implementing Reclamation's Project operational decisions made to satisfy federal obligations like the ESA and Reclamation's tribal trust duties. The district court denied plaintiffs' motion to dismiss and granted PacifiCorp's motion for summary judgment on this part of its counterclaim. (4/27/98 Order at 17-18; ER 581-82.)

This part of PacifiCorp's claim must be viewed in context. In recent years, plaintiffs have claimed that PacifiCorp must, under the 1956 Contract, operate the Link River Dam in a manner that ensures that plaintiffs receive adequate water for irrigation, or face claims for damages. (Landolt Decl, ¶ 4; SER-59-60.) At the same time, the federal defendants as well as other federal agencies directed PacifiCorp to operate the Link River Dam in a manner which would ensure that water be available for protected species under the ESA and to meet tribal trust responsibilities.

Because of these competing demands, PacifiCorp has lost much of the operational flexibility that originally induced Copco to enter into the 1956 Contract. (O'Connor Decl, ¶ 5, ¶ 9; SER-60-62.) Caught today in the middle of other parties' battles, PacifiCorp appropriately sought a declaration that it not be liable as a result of implementing Reclamation's decisions, regardless of whether or not plaintiffs are third-party beneficiaries under the 1956 Contract.

Through their Motion to Dismiss, plaintiffs contended that "PacifiCorp has no obligation under the 1956 Contract or any other law to 'implement Federal Defendants' water allocation decisions'." (App Br at 52.) Stated another way, plaintiffs contend that Reclamation has no authority to direct PacifiCorp's operation of a dam in the Project in order to meet Reclamation's ESA or tribal trust obligations. Under either formulation, plaintiffs' position is that PacifiCorp's request for a declaration that it not be liable for implementing Reclamation's decisions fails to state a claim. Plaintiffs' position is without merit for the reasons stated below.

C. Reclamation Has Responsibility for Management of the Project, Including the Link River Dam

There is no dispute that the Project is a federal reclamation project under Reclamation's management. There is also no dispute that the Link River Dam is owned by Reclamation and is an integral component of the overall management of water within the Project. The 1997 Plan issued by Reclamation, which initially triggered this litigation, addressed operation of the Link River Dam as part of a comprehensive effort by Reclamation to meet its multiple obligations—to irrigators, to threatened and endangered species under the ESA, and to tribes under its tribal trust obligations.

Recognizing that Reclamation's 1997 Plan was a federal action, plaintiffs challenged the Plan under NEPA, 42 USCA § 4321, *et seq.* (1984 & Supp 1998). (Plaintiffs' Complaint, Second Cause of Action; ER 12-14.) In light of the foregoing, it is inconceivable that plaintiffs continue to argue that as a result of the 1956 Contract, Reclamation has no authority over the operation of the Link River Dam and no ability to meet its federal obligations with regard to the operation of the Link River Dam. The result of plaintiffs' argument, of course, would be to place plaintiffs in the envious position of reaping the benefits of a federal project without bearing any of the burdens. However, as much as this outcome may benefit plaintiffs, there is nothing in the 1956 Contract that relieves Reclamation of its federal rights and obligations with regard to ownership of the Link River Dam.

D. The United States Reserved Its Rights Under the 1956 Contract To Control the Flow of Water from the Link River Dam

Plaintiffs argue that in the 1956 Contract the federal defendants relinquished to PacifiCorp any right or obligation to assert control over the operation of the Link River Dam, excepting only for the protection of irrigation. (App Br at 52.) Plaintiffs do not rely on language in the contract, but on extrinsic evidence of "intent." (*Id.* at 53.)

The language of the 1956 Contract clearly provides that the federal defendants retained overall authority over decisions on use of project water for fish and wildlife needs—the needs raised by the ESA and tribal obligations. The 1956 Contract was entered into pursuant to the Reclamation Act of 1902, as amended and supplemented, and "acts of Congress relating to the preservation and development of fish and wildlife resources." (SER-82.) Further, the first sentence in Article 6 states:

> "Nothing in this agreement shall curtail or in anywise be construed as curtailing the rights of the United States to Klamath Water * * *." (SER-85-86.)

This language is clear: the 1956 Contract does not affect in any way the federal defendants' rights to water within the Project, including that which flows over the Link River Dam. Article 6 goes on to state:

> "No Klamath Water shall be used by Copco when it may be needed or required *by the United States* or any irrigation or drainage district, person or association obtaining water from the United States." (SER-86 (emphasis added).)

This provision was drafted in its current form specifically to give Reclamation authority to meet fish and wildlife needs. (See discussion, *supra* at 8-9). In sum, the 1956 Contract makes clear that Copco's use of project water is subordinate *both* to the United States and to those claiming through the United States. It is fully consistent with the 1956 Contract that the federal

defendants have directed PacifiCorp to operate the Link River Dam in a manner to make project water available to the United States to meet its legitimate obligations.

E. Federal Defendants Are Obligated to Comply with the ESA in Directing Operation of the Link River Dam

Plaintiffs contend that federal defendants have no authority to direct PacifiCorp's operation of the Link River Dam to meet the federal defendant's ESA obligations, which arose after the 1956 Contract. To the contrary, under the 1956 Contract federal defendants have the authority and the responsibility to direct operation of the Link River Dam to comply with subsequent legislation, including the ESA.

It is well-settled that federal government contracts are subject to subsequent legislation unless the United States in the contract surrenders, in unmistakable terms, its sovereign power to enact legislation regarding the subject of the contract. *O'Neill*, 50 F3d 677. In *O'Neill*, this court held that water supply contracts between the United States and irrigators that predated the ESA were subject to the ESA because the United States had not "'"surrendered in unmistakable terms"'" its sovereign power to enact legislation. *Id.* at 686 (quoting *Bowen*, 477 US at 52 (citation omitted)). As with the water supply contracts in *O'Neill*, the 1956 Contract does not contain any such surrender,

and therefore "'"remain[s] subject to subsequent legislation" by the sovereign.'" *Id.* (quoting *Bowen*, 477 US at 52 (citation omitted)).

Plaintiffs attempt to distinguish *O'Neill* by relying on *Sierra Club v. Babbitt*, 65 F3d 1502 (9th Cir 1995). In that case, the U.S. Bureau of Land Management ("BLM"), to facilitate access to its land in an area of a checkerboard pattern of alternating public and private forest land, had entered into a reciprocal right-of-way agreement with the owner of the private land. The agreement was entered into in 1962, before enactment of the ESA. The private landowner was required to submit a map to BLM showing proposed new roads before beginning construction. BLM had 30 days after receipt of the proposal to notify the private landowner that the proposed road (1) was not the most direct route, (2) would substantially interfere with existing or planned facilities, or (3) would result in excessive soil erosion. If BLM did not raise any of the three issues within the 30-day period, the landowner could commence construction.

In 1990, the assignee of the landowner submitted a map to BLM showing a proposed logging road across BLM property. Although a BLM biologist determined that the project might affect spotted owls, a threatened species, BLM decided that it was under no obligation to comply with the ESA because

the right-of-way agreement did not give it the discretion to influence the design of the road for the benefit of protected species. *Id.* at 1506.

The Sierra Club filed suit, contending, among other things, that BLM had violated the ESA by failing to consult with the U.S. Fish and Wildlife Service (the "Service") under section 7 of the ESA. On appeal, the Ninth Circuit noted that section 7 applies only to "federal actions," defined by regulation as actions "where [there is] discretionary Federal involvement or control." 50 CFR § 402.16 (1997). Applying these definitions to the right-of-way agreement, the court concluded that "in these narrow circumstances," 65 F3d at 1508, BLM's limited authority to influence the private party's conduct were unrelated to conservation of wildlife, and therefore not "federal actions" subject to the ESA, *id.* at 1509 n 10. The court summed up:

> "In light of the statute's plain language, the agency's regulations, and the case law construing the scope of 'agency action,' we conclude that where, as here, the federal agency lacks the discretion to influence the private action, consultation would be a meaningless exercise; the agency simply does not possess the ability to implement measures that inure to the benefit of the protected species." *Id.* at 1509.

In contrast to the very limited discretion reserved by the agency under the right-of-way agreement in *Sierra Club*, Reclamation reserved unlimited discretion under the 1956 Contract as to its "rights" in the Project water,

including the ability to override PacifiCorp's contractual right to use of such water "when it may be needed or required by the United States." (SER-85-86.) Thus, Reclamation possesses the "discretionary involvement or control" with regard to the operation of the Link River Dam that was lacking in *Sierra Club*.

In a recent case, this court held that Reclamation must comply with the ESA if it has retained any discretion in a contract, distinguishing *Sierra Club*. In *Natural Resources Defense Council v. Houston*, 146 F3d 1118 (9th Cir 1998), *petition for cert filed* 67 USLW 3394 (Dec. 7, 1998) (No. 98-1018), environmental groups brought action seeking to enjoin Reclamation from entering into renewal contracts to supply water from the Friant Dam, asserting violations of the ESA. After the Friant Dam was built, the San Joaquin River terminated at the dam, and water from the Sacramento-San Joaquin Delta was exported upstream to water users below the dam through a process of pumping and reverse flows. This situation adversely affected the winter-run chinook, a listed species under the ESA.

Citing *Sierra Club*, the irrigators argued that Reclamation had no discretion to alter the terms of the renewal contracts and that where there is no agency discretion to act, the ESA does not apply. The Ninth Circuit held that "even if the original contracts guaranteed the Non-federal Defendants a right to a similar share of available water in the renewal contracts, * * * [Reclamation]

had discretion to alter other key terms in the contract, and * * * [Reclamation] may be able to reduce the amount of water available for sale if necessary to comply with ESA." *Id.* at 1126. In the Project, Reclamation has retained discretion under the 1956 Contract to redirect water from PacifiCorp's use "when it may be needed or required by the United States." (SER-86.) Here, the United States needs or requires water to meet treaty and statutory requirements.

Finally, Reclamation asserts in this case that it has the responsibility to comply with the ESA. Section 7 of the ESA applies to all actions in which there is discretionary federal involvement or control. *See* 50 CFR § 402.03 (1997). The determination of whether to engage in section 7 consultation is a decision for the lead action agency. In *Sierra Club*, the court deferred to BLM and that agency's interpretation of the laws it administers. Similarly, this court should defer to Reclamation's determination that it has retained discretionary authority under the 1956 Contract and that it must consult under the ESA. *See Chevron, U.S.A., Inc. v. Natural Resources Defense*, 467 US 837, 844, 104 S Ct 2778, 81 L Ed 2d 694 (1984) ("considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer"); *Thomas Jefferson University v. Shalala*, 512 US 504, 512, 114 S

Ct 2381, 129 L Ed 2d 405 (1994) (agency's interpretation of its regulations given controlling weight unless plainly erroneous or inconsistent).

F. Implementation of Reclamation's Operations Plans Provides PacifiCorp with Its ESA Compliance

Appellants admit that substantive ESA issues were not before the district court, but they nonetheless attempt to pull such issues into the fray by stating that "the limitation on 'take' is PacifiCorp's lone substantive obligation under the ESA" and arguing that this *private* obligation does not form a basis for PacifiCorp to implement Reclamation's *federal* operations plans. (App Br at 54.)

Plaintiffs are correct that ESA section 9 obliges PacifiCorp to avoid the take of listed species, but they fail to inform the court that PacifiCorp can meet this obligation in one of two ways. First, as a private party, PacifiCorp can secure an incidental take permit under ESA section 10. Alternatively, PacifiCorp can implement and comply with applicable terms of an incidental take statement issued to a federal agency under ESA section 7.[15]

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[15] This method of compliance was recently upheld by this court in *Ramsey v. Kantor*, 96 F3d 434 (9th Cir 1996) (holding that states of Oregon and Washington did not need section 10 permit because states' salmon fishing regulations were contemplated by and in compliance with incidental take statement issued by federal agency under ESA section 7).

Recognizing the comprehensive scope of federal control over, and obligations in, the Project, PacifiCorp chose the latter method of ESA compliance. PacifiCorp has worked with Reclamation to develop operations plans that encompass PacifiCorp's operation of the Link River Dam and downstream hydroelectric dams within the scope of activities covered by any incidental take statements issued for the Project.

In particular, in 1996, PacifiCorp and Reclamation consulted with the Service on Lost River and Shortnose Suckers under the ESA. (O'Connor Decl, Ex. 3; SER-16-23.) On July 15, 1996, the Service issued a biological opinion and incidental take statement to Reclamation that covered Upper Klamath Lake downstream to Iron Gate Dam on the Klamath River. (*Id.* at 4; SER-19.)[16]

The consultation considered and included PacifiCorp's operation of the Link River Dam and associated hydroelectric facilities. (*Id.* SER-16-23.) The incidental take statement states in pertinent part:

> "2.3. ***PacifiCorp*** *will assist Reclamation to implement, in 1996, water levels as defined by Reclamation's 'low range elevations' proposal* (Reclamation 1996b). In the future, after Reclamation's consultation on Upper Klamath Lake water levels is complete, ***PacifiCorp*** *shall assist Reclamation to implement new protective*

[16] Plaintiffs reviewed the biological opinion and did not challenge the adequacy of the opinion nor the fact that PacifiCorp was involved in a section 7 consultation.

> *water elevations*." (O'Connor Decl, Ex. 3 at 48; SER-23 (bold in original; emphasis added).)

This incidental take statement protects PacifiCorp from liability for any "take" its hydroelectric projects may cause, as long as PacifiCorp implements the "protective water elevations" contained in Reclamation's operations plans.

In addition to consulting on the two species of sucker fish, in 1996 Reclamation and NMFS formally conferenced[17] on the effects of the Project operations on the coho salmon. (General Biology of Anadromous Salmonids Affected by the Klamath Reclamation Project taken from Reclamation's draft Biological Assessment March 1996 related to Klamath Project Operations Plan and formal conferencing with NMFS; 7/14/97 Declaration of Susie L. Long in Support of Motion to Intervene, ¶¶ 7-9; CR 84; SER-28-29.) In addition, after NMFS listed the coho salmon last spring, Reclamation, the Service, NMFS, and the Klamath Basin Tribes informally consulted[18] on the impacts to downstream salmonids from Reclamation's proposed 1997 Plan. (Klamath

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[17] Conferencing is a procedure to assist the action agency (Reclamation) and the listing agency (NMFS) in addressing potential impacts to species that have been proposed to be, but have not yet been, listed as threatened or endangered under the ESA. 50 CFR § 402.10 (1997).

[18] Informal consultation involves discussions and correspondence between the action agency (Reclamation) and the listing agency (NMFS) to determine whether formal consultation is required. 50 CFR § 402.13 (1997).

Project 1996 Operations Advisory - Scientific Support for Klamath River Flows Below Iron Gate Dam; ER 29.) Reclamation and NMFS are now in the process of formalizing their consultation on coho under the ESA for Reclamation's 1998 Operations Plan. As with the sucker fish, the biological opinion on the 1998 Operations Plan will provide ESA coverage for PacifiCorp if the company implements Reclamation's lake level and river flow parameters.

In sum, reflecting the fact that PacifiCorp operates a dam in a federal project subject to numerous ESA obligations, PacifiCorp satisfies its duties under ESA section 9 by implementing provisions in incidental take statements secured through Reclamation's consultation, under ESA section 7, with appropriate fish and wildlife agencies. Appellants therefore are incorrect when they state that PacifiCorp's own ESA duties provide no basis for implementing Reclamation's operations plans.

G. The Court Is Not Being Asked To Review the Adequacy of Any Specific Project Operations Plan

This case does not require the court to make any findings on the adequacy of Reclamation's 1997 Plan or to speculate on the nature or adequacy of Reclamation's future operational regimes. PacifiCorp asks merely that the court uphold the district court's determination, as a matter of law, that PacifiCorp has no liability to plaintiffs under the 1956 Contract if it operates

the Link River Dam within the parameters of the federal defendants' water operations decisions for the Project pursuant to the ESA and other applicable federal laws. Such a determination does not mean appellants will be deprived of any chance to challenge such water operations decisions; on the contrary, plaintiffs will still be able to file a lawsuit against the government challenging the adequacy of particular annual plans. *See Bennett v. Spear*, 520 US 154, 117 S Ct 1154, 137 L Ed 2d 281 (1997) (zone-of-interests test of prudential standing did not preclude ranchers and irrigation districts from bringing claims under citizen suit provision of ESA expressly allowing any person to bring civil action to enforce ESA). However, such an action should be against the government and not PacifiCorp because any plan would be the federal government's plan developed pursuant to its federal mandates. This is consistent with appellants' own position earlier in this lawsuit when they filed their NEPA claim against Reclamation and did not name PacifiCorp.

VIII. CONCLUSION

Based upon the foregoing, PacifiCorp requests that this Court affirm the decision of the District Court in its entirety. That result will permit plaintiffs to continue with any challenges to Reclamation's water allocation decisions within the Klamath Project through direct claims against Reclamation, and at the same

time assure PacifiCorp that its continuing operation of a federal dam pursuant to Reclamation's directions will not expose it to liability.

DATED: January 6, 1999.

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STATEMENT OF RELATED CASES

Ninth Circuit Rule 28-2.6

Within the meaning of Ninth Circuit Rule 28-2.6, the undersigned counsel of record for Defendant/Counter-Claimant/Appellee PacifiCorp is unaware of any cases related to this appeal.

DATED: January 6, 1999.

STOEL RIVES LLP

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CERTIFICATE OF COMPLIANCE

Ninth Circuit Rule 32(e)(4)

I certify that

1. Pursuant to Fed R App P 32(a) and Ninth Circuit Rule 32, the attached answering brief is

☒ Proportionately spaced, has a typeface of 14 points or more and contains **13,448** words (opening, answering, and the second and third briefs filed in cross-appeals must not exceed 14,000 words; reply briefs must not exceed 7,000 words);

or is

☐ Monospaced, has 10.5 or fewer characters per inch and contains ____ words or _____ lines of text (opening, answering, and the second and third briefs filed in cross-appeals must not exceed 14,000 words or 1,300 lines of text; reply briefs must not exceed 7,000 words or 650 lines of text).

Richard S. Gleason, OSB No. 81239

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EXHIBIT A
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CERTIFICATE OF FILING AND SERVICE

I hereby certify that on January 6, 1999 I filed the original and 15 copies of the ANSWERING BRIEF OF DEFENDANT/COUNTER-CLAIMANT/ APPELLEE PACIFICORP via first-class mail of the U.S. Postal Service to the following:

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I further hereby certify that on January 6, 1999 I served two copies of the foregoing ANSWERING BRIEF OF DEFENDANT/COUNTER-CLAIMANT/ APPELLEE PACIFICORP via first-class mail of the U.S. Postal Service on the following attorneys of record:

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