October 27, 2006

Bonneville Power Administration
Public Affairs Office – DKC-7
P.O. Box 14428
Portland, OR 97293-4428

Re: Regional Dialogue: Service to Direct Service Industries

Alcoa Inc. ("Alcoa") appreciates the opportunity to provide these comments on Bonneville Power Administration's ("BPA") proposals concerning the manner in which BPA will provide the benefits of the Federal Columbia River Power System ("FCRPS") electric power service to its customers, including service to the Direct Service Industries ("DSI") for the period beginning in 2011. BPA's effort to achieve consensus and to give power planners in the region some certainty concerning BPA's role deserves the support of the region's utilities and planners and Alcoa supports BPA's efforts. The objective of regional consensus and certainty cannot be achieved if BPA leaves the remaining DSIs without an adequate and economical future power supply. But as stated further in this letter, Alcoa can support a BPA proposal to provide Alcoa a proportionate share of the 560 aMW identified as an option in BPA's Regional Dialogue Policy paper as a means of fairly sharing BPA's reduced role in providing electric power service within the region.

In the absence of regional consensus, BPA has articulated the broad elements of a fallback proposal. While this is clearly not the desired solution, Alcoa is prepared to work with BPA to put in place BPA's fallback position, if required. Under that approach, we propose that BPA use a somewhat different method of providing 560 aMW of power to the DSI customers—one that would follow the expectations of the Northwest Power Act and the Regional Preference Act.

In this letter Alcoa emphasizes the following points with respect to DSI service regardless of whether BPA adopts its consensus proposal or is required to adopt a fallback option:

- Fairness requires that, after being a BPA customer for 66 years, Alcoa should continue to receive cost-based power from BPA. The continued provision of electric power to such a long-term customer at an average cost-based rate is not a subsidy.

- Alcoa should be treated like other industries that were located in preference utility service territories prior to 1979.

- The Northwest Power Act did not contemplate, and does not allow, BPA voluntarily to put itself in the position of being resource deficit and as a consequence, to decline to serve DSI loads.

- Other customers have no reasonable expectation or right to revenue credits made possible by extra-regional surplus sales unless and until regional power loads (including the DSI loads) have been served at cost.

- Fortunately, BPA has sufficient surplus power to provide reliable service to the DSIs under most operating conditions.

- Economic studies demonstrate that: 1) Alcoa's smelters can operate at profitable levels given expected long-term aluminum prices if Alcoa receives cost-based BPA power; 2) the region receives a net economic benefit from providing electric power service to the DSIs, even if BPA is required to serve all DSI needs with purchased power; 3) the Alcoa smelters have a large economic impact on the communities within which they are located.

- Alcoa itself needs 625 MW of power to serve Intalco and the unserved portion of its Wenatchee smelter. However, to achieve long-term certainty and to make service to the DSIs more acceptable to other BPA customers, Alcoa is willing to compromise on 560 aMW of service to DSI loads through service from local utilities and to have that amount of power subject to allocation between the remaining DSIs.

- Because of the already substantial declines in DSI load, if any DSI is unable to take the service offered by BPA, then the remaining operating DSIs should receive a pro-rata allocation of the unused power, consistent with the approach BPA has adopted for the 2007-2011 contracts.

Alcoa is the world's leading aluminum producer and currently employs over 129,000 people in 43 countries. Alcoa has been a BPA customer since its first contract with BPA in 1940. It has two smelters located in the Pacific Northwest that have historically been served by BPA, one in Ferndale, Washington ("Intalco") and the other in Wenatchee, Washington. Intalco has received the bulk of its electric power service from BPA. Historically, half of the Wenatchee smelter's load has been served by Chelan County PUD and half of the load by BPA. However, today Intalco is operating at only one-third of its capacity and Wenatchee is operating at one-half capacity (using entirely Chelan PUD power). As previously announced, Intalco will open a second potline next year due the short-term BPA Monetary Benefits contract and short-term aluminum and power market factors. This confluence of factors has merely created a bridge for Alcoa to operate its smelters in anticipation that BPA will, as it has in the past, sell power to Alcoa at cost-based rates for the period beginning in 2011.

As BPA considers how to achieve a fair and balanced result from its Regional Dialogue, Alcoa asks that BPA consider one important fact. Since the mid-1990s, DSI loads have been reduced from over 3100 MW to well less than 1000 MW. BPA is now proposing to provide a maximum of 560 aMW of power to the DSIs. Without the decline in the DSI class of load, BPA would need to augment its system by well over 2400 MW in order to achieve electric power service to those customers that existed when the Northwest Power Act was passed. Rather than viewing the remaining DSI load as incremental, BPA should view the remaining DSI load as an important remnant of the cornerstones of the Northwest Power Act. Since May 2000, Alcoa loads formerly served by BPA at Troutdale, Longview, and Addy have been reduced by more than 700 MW. Thus, Alcoa's reductions in loads, alone, have permitted BPA to serve that amount of public agency and cooperative load growth without any additional augmentation. With this history, it is ironic (and inaccurate) to assert that Alcoa or the other remaining DSIs propose to impose costs on BPA's other customers that constitute a subsidy to the aluminum smelters.

Historical context

Alcoa's historic reliance upon BPA for a large share of its total electric power has benefited BPA and its other customers as well as Alcoa. In BPA's early years, immediately following passage of the Bonneville Project Act, BPA needed a market for its power and many of the publicly owned customers of today ("public bodies and cooperatives" or "preference customers") had not yet been formed. For that reason, BPA began serving Alcoa in Vancouver directly because Clark County PUD did not yet exist. BPA needed the cash flow it got from DSI loads in order to assure repayment of the Federal Treasury for the cost of constructing Bonneville Dam (and the later Federal projects) and the related transmission. In recognition of this situation, the Bonneville Project Act reserved to preference customers fifty percent of power prior to January 1, 1942 (16 USC § 832c(b)), allowing the remainder to be sold to DSIs and other non-preference customers on an unrestricted basis.

With the ensuing crises of World War II and the Korean conflict, the natural transition to service of the aluminum smelters (and other DSIs) by preference customers never took place and BPA continued to directly serve the DSIs. This arrangement proved to provide both financial and operational stability to BPA. Over the years, the DSIs contributed roughly one-third of the revenues BPA used to repay the Federal and other debt (and to build equity in the Federal system). During this time many new preference customers were forming. Characteristically and naturally, these new publicly owned utilities had little or no beginning equity and were without the means or ability to forecast loads. The DSIs served as financially strong contract parties and flat loads. The DSIs also provided operating, planning and stability reserves that reduced the need for BPA to build redundant generation. In addition, the DSI loads provided BPA with a source of revenue from water that would otherwise have just spilled over the dams. Of course, the

DSIs also benefited from this arrangement and DSI loads ultimately grew to a demand of 3,147 MW.[1]

These mutually beneficial arrangements continued up until the time BPA gave "notice of insufficiency" of its generating resources to meet loads in June of 1976. This would have triggered allocations of power to preference customers. It is clear that the DSIs could have sought power from the preference customers in whose territories the various DSIs were located at that time. At the same time, the State of Oregon, through formation of the Domestic and Rural Power Authority, and the City of Portland indicated that they would seek allocations of power from BPA, at least for residential and small farm loads through the formation of new preference customers. Faced with the prospects for fighting over an insufficiency of power, consensus formed within the Northwest and the Northwest Congressional Delegation for legislation that would assure that the benefits of BPA's power supply would be spread between BPA's customer groups: preference customers, investor-owned utilities and the DSIs.

BPA recognized, in an official paper notifying preference customers of its proposed allocations[2] that the DSIs could call upon the utilities that they adjoined to provide electric power to the DSI loads. BPA cautioned that this arrangement would: 1) disproportionately benefit the utilities in whose service territories the DSIs were located; 2) result in less efficient use of the reserves that the DSIs provided; and 3) not solve the regional insufficiency of power that gave rise to the need for the allocations.

Impact of the Northwest Power Act

Precisely to avoid the need for an allocation of power and to cure the insufficiency of power giving rise to the regional divisions, public and private utility leaders, the DSIs and BPA began work on a legislative solution. A central purpose of the Northwest Power Act was "to assure the Pacific Northwest of an adequate, efficient, economical and reliable power supply."[3] The Act was specifically designed to avoid the type of allocation of power between competing customer groups that otherwise would have been required in the absence of the Act. BPA was "deemed" to have sufficient quantities of power to provide electric power service to each of the three customer groups in order not to run afoul of the preference provisions of the Bonneville Project Act.[4] Thereafter, the Administrator was to acquire resources sufficient to meet the loads anticipated in the Northwest Power Plan.[5]

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[1] Beyers, O'Carroll and Sorenson, "Regional Employment and Economic Impact Study" September 8, 2006 handout, Table 1.
[2] The Senate Report on what became the Northwest Power Act reflects this fact by assuming in the numerical analysis of the rate directives that, in the absence of the Act, 85 percent of DSI load was within or adjacent to the service territory of public bodies and cooperatives and would have been served through the public bodies and cooperatives. S.R. Rept. 272, 96th Cong., lst Sess., at 58.
[3] 16 USC § 839(2).
[4] 16 USC § 839c(g)(7).
[5] 16 USC § 839b(d)(2).

In the absence of the Act, the DSIs could have called upon their local preference utilities to provide them with electric service at a cost-based rate. Some, including Cowlitz PUD, in fact initially insisted upon the right to provide service to the DSIs. But other preference customers opposed that approach, as it would concentrate the benefits of the flat and interruptible DSI loads in the hands of only a few public utilities. Only after receiving assurances of the right to a continued power supply from BPA did the DSIs agree to "the regional solution" that was the Northwest Power Act. The Act did not contemplate that service to the DSIs would end after the first contracts expired. The Act refers, as it does to all of the customers' contracts, to "initial long term contracts" for the DSIs.[6] In the absence of a sunset provision, it is normally presumed that statutory rights and obligations will continue (such as BPA's obligations to acquire resources to serve all customers, to sell power to existing direct service industrial customers, etc.).

The DSIs agreed as part of the Northwest Power Act to: 1) surrender their right to call upon the preference customers in whose service territories they were located to provide them with BPA power at preference rates; and 2) to pay for the entire residential exchange for the first five years under the Act, and to potentially pay for a portion of the exchange through BPA rates thereafter (through a floor rate). The residential exchange was the basis for the investor-owned utilities, the State of Oregon and the City of Portland giving up their claims for preference power through formation of special purpose public bodies. After the initial five years, the DSI rates were to be "equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial customers in the region." In other words, the DSIs were to subsidize the start-up of the regional exchange with the investor-owned utilities. In return, they were to receive "initial" (and by implication follow-on) contracts that would have achieved essentially the same rates as they would have paid had the Act not been passed, and had they received BPA preference power through the local public utility.

That this was the intention of Congress, and the understanding of the region's utilities, including BPA, is beyond dispute. In fact, the Act is full of tests and limitations reflecting this understanding:

a. The Act prohibited BPA direct service to "new" DSIs, and defined as "New Large Single Loads" service to a new or old load that was not contracted for or committed to by a regional utility prior to September 1, 1979. This provision was necessary to cause the DSIs to surrender the right they otherwise would have had to call upon the local public utility to provide it (indirectly) with BPA power.

b. The "rate test" contained at Section 7(b)(2) presumes, in establishing the hypothetical circumstances that would have existed in the absence of the Act, that "the public body and cooperative customers' general requirements had included….the direct service industrial customer loads…"[7] In other words, the rate test recognizes what would have happened in the absence of the Act and provides no greater guarantee of benefit

[6] 16 USC § 839c(d)(1)(B) and § 839c(g)(1).
[7] 16 USC § 839e(b)(2)(A).

than the publics would have achieved without the Act. It further reflects the understanding that the DSI loads would continue beyond the initial contracts in the Act (as the rate test continues perpetually).

c. The Administrator was prohibited from selling power to new DSIs and from selling additional amounts of power to existing DSIs unless the Administrator determined on the basis of a regional plan the proposed sale was consistent with the plan, and 1) the additional reserves were required for the region's firm loads, 2) the additional sale would be a cost-effective way of acquiring the reserves and, finally and most importantly, 3) "the Administrator has or can acquire sufficient electric power to serve such [increased DSI] loads…."[8] Similarly, BPA could offer a new contract to an existing DSI that had not received power prior to the Act "conditioned on the Administrator reasonably acquiring…sufficient resources to meet, on a planning basis, the load requirement of such customer."[9]

It is significant that no such test for acquiring "sufficient electric power" applied to service to the DSI loads as they existed on the date of passage of the Act either for the "initial long term contracts" or for any follow-on DSI contracts. Why? Because it was presumed that BPA would acquire sufficient generating resources to provide power to all of the customers it was statutorily authorized and obligated to serve, including the DSIs. There was no "adequate resources" test for meeting existing DSI loads for follow-on contracts. If BPA couldn't acquire sufficient generation, then it wasn't authorized to provide additional power to the DSIs or to serve an "existing DSI" that had not previously received power from BPA.[10] By implication and through application of rules of statutory construction, this same limit did not apply to providing the DSIs with the amount of power they were entitled to under their pre-Act contracts for purposes of entering into the "initial long term contracts" or follow-on contracts. Naturally, the long-standing statutory preference right to power of public bodies and cooperatives would apply if BPA was unable to acquire sufficient power to serve existing DSIs (who had previously been served by BPA) after entering into contracts, but BPA was not authorized to voluntarily fail (i.e., refuse) to acquire resources so that it would not be able to serve such existing DSIs. In other words, BPA could not plan *not to serve the DSIs.*

d. The Act authorized BPA to sell electric power to the DSIs (with no mention of a time period limitation) and required that such sales "provide a portion of the Administrator's reserves for firm power loads within the region." Again, this latter requirement had no time limitation.[11] This provision is significant for two reasons: First, the only way for the Administrator to meet this requirement for DSI sales to provide for a portion of BPA's reserves is for a power sale to continue to take place after the "initial long term contracts." Second, unlike many other provisions of the Act that were limited

[8] 16 USC § 839c(d)(3)(A) through (D).
[9] 16 USC § 839c(d)(4)(C)(i).
[10] The DSI in this context was "existing" by virtue of having a pre-existing BPA contract, but without having received power under that contract.
[11] 16 USC § 839(d)(1)(A).

in time, this authorization to sell power to the DSIs and the obligation to obtain a portion of the Administrator's reserves from the DSIs is not time limited. If Congress had intended to limit the DSIs contracts to the "initial long term contracts" it would have provided for such an express limitation. Certainly Congress knew how to do so, and it knew how to do so precisely with respect to the DSIs (*see* the limitation of the DSIs payment for the exchange sales in 16 USC § 839e(c)(1)(A)). Similar end-dates for authorities, obligations or transition dates are expressly contained elsewhere in the Act.[12] In the absence of such an end-date, under conventional rules of statutory construction, the statutory obligation is presumed to continue.

The Northwest Power Plan Contemplates DSI Service

The Northwest Power Act requires that "all actions of the Administrator pursuant to section 839d of this title shall be consistent with the plan and any amendments thereto, except as specifically provided in this chapter." The Fifth Power Plan of the Northwest Power Planning Council reflects DSI loads.[13] 16 USC § 839d provides that acquisition of resources shall be consistent with the plan, as determined by the Administrator. The Northwest Power Act did not contemplate, and does not allow, BPA voluntarily to put itself in the position of being resource deficit and as a consequence, to decline to serve remaining DSI loads that are correctly reflected in the Northwest Power Plan.

It may well be that the region (and BPA) have reached the conclusion that the basic concept of the Northwest Power Act -- that BPA would augment the system by constructing or buying generating resources to meld with the costs of the Federal Base System resources -- is no longer the best approach for meeting the region's loads. The premise of the Regional Dialogue to allocate existing BPA resources into one pool (Tier 1) and to acquire additional resources to meet regional load growth from another pool (Tier 2) may well be the preferred method for achieving a predictable future for the region's utilities. However, under this construct, it is not a reasonable, equitable, or lawful to say that the DSIs should not receive any Tier 1 power service. Instead, under this approach, BPA should abandon any pretense that the DSIs are a separate class of customer and instead sell power to local utilities at a PF-equivalent rate for resale to the DSI customers, in the same way that BPA is now serving Port Townsend Paper (and the region's other industrial customers in or adjacent to the service territories of public bodies and cooperatives).

The foregoing approach has the virtue of preserving the relative equity envisioned by the Northwest Power Act and the Regional Preference Act, while at the same time requiring the DSIs to participate in this two-tiered system (by serving less than the DSIs' full loads). This approach also has the virtue of putting the DSIs, the preference customers and the preference customers' own industrial consumers on the same level

[12] *See* 16 USC §§ 839e(i)(6) (last phrase), 839e(b)(2); 839c(c)(2) (phase-in of the amount of power subject to the residential exchange), 839b(k)(1) (limitation on conservation measure and resource funding after October 1, 1987 if such measure proved not to be cost-effective).
[13] Fifth Northwest Electric Power and Conservation Plan, Appendix A, at A-43.

plane they would have been on in the absence of the Act and in the same relative position as that envisioned by the DSI rate provision of the Act. This would go a long way to quell the disruptive and long-standing disagreements between preference customers and DSIs because it would align the interests of the preference customers, their industrial customers and DSIs on a going-forward basis and provide consistent treatment to the remaining non-aluminum DSI and the aluminum DSIs.

By carving out 560 aMW of resources to serve the aluminum DSIs, BPA would simultaneously limit its DSI load exposure, require the aluminum DSIs to bear a fair portion of the reduction in resources resulting from allocation, leave the DSIs or their serving utilities in a position to craft a method for making up the remaining DSI load requirement, and yet retain some portion of the DSI load interruption rights that have proven to be important to the region at various times in the history of BPA and the DSIs.

The Regional Preference Act[14] Requires That Northwest Loads Be Served Prior To Selling Power Outside The Region

A number of customers have asserted that it would subsidize the DSIs for BPA to forego sales outside the region at market rates that are often double, or more, than the Northwest cost-based rates in order to provide electric power service to the DSIs at cost-based rates. The logic goes that since the revenues from such surplus power sales would go to reduce BPA's preference customer rates, any sale to a DSI somehow robs the preference customers of a right. This logic is seriously flawed as both an economic proposition and as a legal matter:

A. Power sold "at cost" has never been considered "subsidized." If the measure of subsidy is a sale at average cost, when a sale could otherwise be made at marginal cost, then any sale of power at average cost would be a subsidy, and all BPA sales except those at marginal cost would be subsidized. This is nonsense. Utilities have been selling power at blended cost-based rates to their customers for decades. Even in the heyday of marginal cost pricing for utilities following the enactment of the Public Utility Regulatory Policies Act, it was recognized that unless utilities were to be paid windfalls, their power prices would have to be constrained (in the aggregate) to average cost, and they were.

B. As a legal matter, because of the "Regional Preference Act," sales of power may not be made outside the region if there is demand for the electric power in the Northwest at an established, cost-based rate.

In 1963, it became clear that emerging technology would permit long-distance direct current transmission of electric power from the Pacific Northwest to the Pacific Southwest. The capacity and energy exchanges that could take place would maximize

[14] P.L. 88-552, codified at 16 USC §837 et seq.

the use of cost-effective generation and save both regions money. But one obstacle was paramount: California had large numbers of its own public agencies and cooperatives that were eligible to be preference customers under the Bonneville Project Act and the Flood Control Act. In addition, the California utilities had much higher generating costs, so, if a bidding war ensued, most Northwest Power would be sold into California because the California preference customers could afford to pay more for the BPA power. This fact proved to be a legal obstacle to the efficiency that could be achieved through inter-regional sales of power. The solution to this dilemma was what became known as the Regional Preference Act. The Act defines "surplus energy" as:

> electric energy generated at Federal hydroelectric plants in the Pacific Northwest which would be otherwise wasted because of a lack of a market therefore in the Pacific Northwest at any established rate.[15]

Surplus peaking capacity is similarly defined.

BPA claims that there is a Northwest regional preference to *access* to FCRPS power, but no regional preference to the cost-based price. This has caused others to argue that BPA may make extra-regional sales of electric power so long as it offers such power at the same rate in the Pacific Northwest and outside the region, and the monetary benefits of those sales are credited against preference customer rates. But the very existence of the Regional Preference Act and its remarkably clear legislative history contradict that view. The evil that the statute was designed to cure was the ability of the Southwest to outbid the Northwest for hydroelectric power generated in the Pacific Northwest. It completely disregards the essential purpose of the statute to say that a market based or variable rate structure that permits the Pacific Southwest to outbid an historic Northwest customer satisfies the "any established rate" requirement of the statute. To make sales outside the region due to higher bids negates the Congressional intent to first serve all Northwest interests at cost-based rates before offering the surplus power outside the region.

If the rather clear language of the statute leaves any doubt about Congress's objectives in enacting the Regional Preference Act, the legislative history eliminates the doubt:

- Should the transmission facilities be constructed without some statutory definition of the marketing area of Pacific Northwest energy, preference agencies outside the Pacific Northwest ***could demand power under existing law that is needed in the Pacific Northwest to meet the power needs of nonpreference utilities and industrial customers.*** This would not be a desirable situation from either an economic or a public relations

[15] 16 USC §837(c).

viewpoint and could disrupt the entire economy of the Pacific Northwest. (*Emphasis supplied*).[16]

- Industrial customers of the BPA have invested more than $350 million in their plants. *If Federal power generated in the Pacific Northwest is diverted to other regions, many of these industries would be seriously affected.*[17]

- …once the interconnecting lines are constructed and available, the preference customers in the Pacific Southwest could demand that the secondary power continue to flow to them even though it might be needed in the Pacific Northwest. *They also could demand that firm power needed by nonpreference utilities and by the electroprocess industries in the Pacific Northwest be delivered to them. This bill is necessary to permit the sale of the dump power to the benefit of everyone without endangering the power supply of people in the Pacific Northwest who depend upon the Federal Columbia River system* ***for an economic supply*** *of power*. (*Emphasis supplied*). [18]

- A California Congressman wrote, in opposition to PL 88-552: "Customers outside the Pacific Northwest would have to incur the financial burden of building high-cost steam powerplants to meet their increasing needs for power. — Federal power customers (preference as well as nonpreference) in the Pacific Northwest would be permitted to enjoy almost exclusively the low-priced power produced in Federal hydroplants on the Columbia.[19]

The foregoing legislative history (and literally dozens of similar excerpts) makes clear that the Regional Preference Act was intended to satisfy the power needs of Pacific Northwest customers, including the non-preference customer DSIs, and to do so to create "an economic supply of electric power" including for BPA's "industrial customers" in a way that those in the Pacific Northwest "would be permitted to enjoy almost exclusively the low-priced power produced in Federal hydroplants." In other words, the Regional Preference Act was ***not*** intended to be used as a device exclusively for keeping the Northwest preference customers' rates low by granting revenue credits for sales of power generating revenues of whatever the market will bear for sales to California. Even before power can be deemed to be surplus, it must first be offered in the Pacific Northwest at an established (cost-based) rate precisely to preserve the economic value for the Northwest, including the DSIs.

<u>BPA Has Sufficient Surplus Power To Provide Reliable Service To The DSIs</u>

[16] H.R. Rept. 590, 88th Cong., 1st Sess., at 3.
[17] Id.
[18] S.R. Rept. 122, 88th Cong., lst Sess. at 6-7.
[19] H.R. Rept. 590, id. at 32.

Based on BPA's own estimate of loads and resources, BPA has sufficient surplus power (in excess of net requirements) to serve all 560 aMW of the load DSI proposes to provide to the aluminum DSIs. Under almost all operating conditions, BPA has sufficient power to provide for the upper limit BPA proposes to provide to the DSIs. The Northwest Power Planning Council recently described how the power supply situation in the Northwest has changed a good deal since 1999 when the region was about 4,000 average megawatts deficit. The region has lost ten percent of its demand and has gained fifteen percent in generating capacity, leading to about 2,400 average megawatts of surplus, on average.[20] Indeed, BPA forecasts surplus power revenues for 2006 that may well exceed its prior record for surplus sales set in 2005.[21] Clearly the region has sufficient surplus power to provide 560 average megawatts of sales to the DSIs, as well as to realize surplus sales revenues to reduce its public agency customer rates.

BPA will require only modest augmentation of its resources in order to provide the upper limit level of power service to the DSIs proposed in the Regional Dialogue Policy paper. This is especially true if some of that power is provided on a less-than-firm basis to provide economical power reserves. Based on this fact, there is no reasonable basis for BPA to do other than adopt the 560 aMW power service proposal for the aluminum DSIs. More importantly, in this circumstance, and under the Regional Preference Act, BPA does not have discretion to refuse to provide electric power service to the aluminum DSIs.

The 560 average megawatts of power that BPA proposes to provide to the aluminum DSIs falls far short of meeting the DSIs requirements. However, it is consistent with the amount of power upon which BPA based its 2007-2011 contracts to the aluminum DSIs—a number arrived at after many public comments and careful consideration of the appropriate balance to achieve between its customers' varied interests. It would be unfair, in the extreme, to further reduce the amount of power provided to the aluminum DSIs in the name of "reaching a compromise." Alcoa has already reduced its regional load through the closure of smelters, and BPA's 560 aMW proposal (if applied in the same way as the initial allocations in the Block Power Sales Contracts with the DSIs for 2007-2011) would provide only 320 aMW to serve Alcoa's unserved load of 625 aMW. Alcoa would thus see, at least initially, only 51 percent of its remaining load served by BPA while other NW industries would initially have 100% of their loads provided by low-cost BPA Tier 1 power. BPA's 560 aMW proposal already substantially reduces BPA service to the DSIs and should not be further reduced.

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[20] Memorandum to Northwest Power and Conservation Council Members on Power Supply Outlook for 2006-2007 dated October 18, 2006.

[21] Since 2003, BPA has averaged in excess of $500 million in annual revenues from sales of surplus or secondary energy. Through the 3rd quarter of 2006, BPA received over $522 million from sales of electricity outside the Northwest and the projection for the 4th quarter of 2006 is about $200 - $250 million. BPA's FY 2006 sales of electricity to customers outside the region could reach $750 to $800 million, easily exceeding the record sales of $565 million set in FY 2005. BPA Quarterly Financial Report, 1st Quarter 2006.

Some have suggested that BPA should make a further change from the Block Power Sales Agreements currently in effect for the aluminum DSIs and do away with the ability of the DSIs to obtain additional power allocations from the DSI class if any of the other smelters shut down. Such a proposal would further erode BPA's historic service to the DSI loads and reduce the chances of the remaining smelters being viable for the full term of the contracts. In order to reduce future acrimony and to put in place a known obligation to the DSIs, Alcoa urges that BPA permit the reallocation of unused DSI power to the remaining DSIs without limitation. This will have the benefit of fixing BPA's power obligation at a predictable level and maximize the chances of keeping some aluminum production in the Pacific Northwest. Naturally, the aluminum DSIs would prefer to see their entire loads met with BPA power, as in the past, and as will be the case for other Northwest industries; but Alcoa recognizes that 560 aMWs of service to the DSIs has already been vetted as an economic milestone that is affordable to the region.

The Economic Analysis Performed By Independent Economists Demonstrates That The Region's Economy Is Best Served By Providing Power Service To The Aluminum DSIs

In response to many comments from the region, BPA determined that it should empanel an independent group of economists to determine the cost and value of the aluminum smelter loads to the region. Alcoa submitted to BPA two studies, the first, from CRU Strategies taking a macroscopic view of the viability of Alcoa's plants given world economic conditions for aluminum plants; the second, a 2006 update of a 2000 study performed by Dick Conway & Associates measuring the Economic Impact of the Washington State Aluminum Industry. The PPC commissioned a study by Hamilton Water Economics and Economic Modeling Specialists entitled "Economic Impacts from Rate Increases to Non-DSI Federal Power Customers Resulting from Concessional Rates to the DSIs."

In summary, the studies demonstrate:

- "Given the expected prices of cost-based power from [BPA], we expect that if BPA decides to provide enough power to allow Alcoa to operate its Ferndale and Wenatchee plants at capacity, those plants will likely operate for the indefinite future." CRU Strategies Northwest Smelter Operating Outlook at 4.

- "If a rise in aluminum prices coupled with a decline in electricity costs were to permit operation of the Alcoa facilities at full capacity in 2011, for example, the aluminum industry would support about 0.2 percent of the state's [Washington's] economic activity." Conway Study at 6.

- The economic impact of full production on Chelan County would amount to 1,630 jobs (3.1 percent of the county total), $61.6 million in personal income (2.9 percent), and $2.4 million in local taxes (3.2 percent). The impact on Whatcom

County would total 2,850 jobs (2.6 percent), $141.6 million in personal income (2.6 percent), and $5.3 million in local taxes (2.6 percent). Id.

- Under any circumstances, including the most unfavorable assumptions made by the PPC-commissioned study, a net increase in jobs and income impact would result from providing cost-based service to the remaining regional aluminum smelters (after considering the potential rate impact of serving DSIs on non-DSI industrial customers). Beyers, O'Carroll and Sorenson Impact Study, Table 22.

In other words, the studies demonstrate what many of BPA's other customers asserted was otherwise: The net impact of having the remaining aluminum loads served at cost-based rates is positive for the region. Faced with the compelling legal and equitable arguments in favor of continuing electric power service to the aluminum DSIs, this additional evidence of positive economic impact of DSI loads should convince BPA that it should select the alternative that would provide 560 aMW of cost-based electric power service to the aluminum DSIs through sales to the DSIs' adjacent preference utilities.

Alcoa Is Prepared To Accept as a Compromise BPA's Proposed 560 aMW of DSI Service

Alcoa's load for its two remaining smelters (net of service provided by Chelan PUD) is 625 MW. Therefore, BPA's proposed level of service to all five remaining aluminum smelters of 560 aMW of power is insufficient to meet Alcoa's needs, let alone all the DSIs' needs. The 560 aMW is not a "high point" representing either the peak or even likely loads of the remaining DSIs. It is merely a continuation of the proxy load adopted for the 2007 to 2011 DSI contract Monetary Benefits. Even if Alcoa was able to purchase all of the 560 aMW of power for its own plants, it would still be forced into the power markets to purchase 65 megawatts of power.

Nevertheless, Alcoa accepts the 560 aMW proposed to be dedicated to aluminum customer loads as a reasonable compromise between the region's interests in reducing BPA's revenue requirement and the aluminum smelters' need for a reasonable chance of survival.

As BPA makes its determination, Alcoa hopes that BPA will keep in mind that Alcoa itself has reduced its load on BPA by more than 700 MW through smelter closures. This is power that is otherwise available to the region. So in a very real way, Alcoa has helped BPA keep rates down for the other customers. Through acceptance of the 560 aMW figure, Alcoa is willing to compromise its own interests in favor of achieving a reasonable balance that recognizes all of BPA's customers will bear some costs associated with the long-term insufficiency of firm power required to serve BPA's loads.

In accepting this compromise, Alcoa urges BPA to retain the 560 aMW load threshold open for reallocation between the DSIs. Recall that under the initial allocation

represented in the 2006-2011 contracts, Alcoa will only receive 320 MW of power, and is only eligible for up to 438 MW of power even if other DSIs do not use their share. Even at the maximum amount, this is not enough power to operate Alcoa's Northwest plants at the near-capacity levels they need to be run at for maximum efficiency. Any and all reductions in other aluminum DSI loads should be re-allocable to the remaining DSIs so at least some plants can have a chance at operating at efficient levels.

Alcoa appreciates the careful consideration that BPA has given to its new role in the region. It asks BPA to recognize that its smelters have the greatest chance of surviving for the long term in the Northwest. Given a fair, cost-based rate, Alcoa is prepared to sign a 20-year take or pay contract for its allocated share of the 560 aMW of BPA power contained in BPA's power service alternative.

The Northwest region should come together to find alternatives that all customers can live with. Clearly, Alcoa cannot agree to any alternative that would not permit it to continue to operate its smelters in the Northwest for the long term. Therefore, the Monetary Benefits and "no service" alternatives are unacceptable to Alcoa, and we believe will only lead to further conflict within the region. In the absence of BPA's compromise solution to provide 560 aMW of power to the DSIs at BPA's average cost, Alcoa would have no choice but to press on with its efforts to defend its broader legal rights to power.

To summarize Alcoa's position:

1. Alcoa and the remaining DSIs should not be penalized for supporting the regional solution proposed by the Northwest Power Act by being singled out not to receive any power from BPA. This result is both unfair and unlawful under the circumstances that exist today.

2. As BPA moves forward to adopt a new role in the region, it should resolve to treat Alcoa, as closely as possible, as it does the region's other large industrial customers served by the region's publicly-owned utilities. This is consistent with what would have happened under the regional power deficit that existed prior to the Northwest Power Act, and this approach is consistent with the result contemplated by Congress in the pricing provisions of the Northwest Power Act. It is also consistent with the treatment adopted by BPA for Port Townsend Paper Company in the 2007-2011 contracts.

3. The Regional Preference Act protects Alcoa's access to BPA power prior to a sale outside the region. BPA can provide sufficient power to Alcoa, at cost, without unduly harming BPA's other customers. In any event, BPA may not ignore Northwest Preference to artificially lower preference customer rates. If BPA adopts Alcoa's proposed terms of service, the tension between preference customers and DSIs over DSI service will be substantially reduced.

4. The economic studies that BPA asked for and received demonstrate that the region receives a net financial benefit if the aluminum smelters receive service. The smelters are particularly important to the rural communities within which they operate. The studies also demonstrate that Alcoa's smelters are economically viable over the long term if Alcoa receives cost-based power from BPA.

5. Although Alcoa itself needs 625 aMW of additional power from BPA in order to operate its remaining Northwest smelters, Alcoa is willing accept, as a compromise, the provision by BPA of 560 aMW of power to the aluminum DSIs in the interest of developing regional consensus and a fixed obligation for BPA to plan around.

The most defensible position for BPA to take, both as a matter of fairness and of conformity to the Northwest Power Act and the Regional Preference Act, would be for BPA to adopt the 560 aMW power alternative. We pledge to work closely with BPA to implement a fair and balanced contract if BPA adopts this alternative.

Sincerely,

Jack A. Speer
NW Vice President
Government and Energy Affairs