Northwest Aluminum Industry Study Group
January 26, 2001
Portland Airport Sheraton, Portland, Oregon

The Northwest Aluminum Industry Study Group met from 9:30 a.m. to 12:00 p.m. Twelve study group members were present, with about 20 people in the audience. The group discussed whether to continue the study. The consensus was to suspend the group's activities for the time being and to reconvene, if needed, as a regional sounding board for BPA's proposals with regard to DSI contracts.

Agenda

Facilitator Dick Adams laid out the meeting agenda, beginning with a BPA report on new DSI contract provisions related to how the companies use revenues from power remarketing and buybacks. He said the study group would also revisit its charter "to see if the mission still makes sense." BPA attorney Jon Wright explained that due to the rate case, BPA was under the *ex parte* rule, and he was present to make sure the discussion did not stray into a rate case-related topic.

Steve Oliver of BPA reported that the region has an aluminum-smelting load of about 3,300 aMW, of which BPA is obligated to serve 2,200. Half of the power to serve that load was sold with remarketing rights and half was not, he said, adding that when DSI contracts were signed in the mid 1990s, BPA was worried about having stranded resources. BPA wanted five-year, take-or-pay contracts and designed "a risk-management tool" in the form of a remarketing provision as incentive for the DSIs to sign on, Oliver said. "Things have changed completely," he acknowledged. With the market as high as 50 or 100 times what was anticipated, the DSIs have the opportunity for "a massive windfall" from remarketing power, Oliver stated.

BPA's obligation to serve DSI load goes down after September 30, 2001, and the agency is working with the companies to reshape power as they gear operations to their post-October contracts, he continued. It was apparent there were opportunities in this process for the companies and the region to reconsider the use of Columbia River power in a $200 per megawatt-hour (MWh) market, Oliver explained. BPA is working on remarketing and buyback arrangements and on getting agreement that if a DSI sells into the market and receives a windfall, the revenue will be used for mitigating impacts to affected employees, making arrangements for long-term power supplies, and/or applied to fixed costs that must be met even when operations are reduced, he said.

According to Oliver, Goldendale/Northwest Aluminum and Columbia Falls Aluminum Company (CFAC) have reached agreement with BPA on remarketing, and other companies, including Kaiser, are negotiating. Buyback offers have been made to loads without remarketing rights, he acknowledged, including the smelter at Longview, which is being sold to McCook Metals. Oliver said that deal is contingent on McCook finalizing the smelter purchase.

Why does the CFAC agreement go beyond October 1, 2001? asked Jerry Leone of the Public Power Council (PPC). CFAC was willing to curtail load beyond the current contract period, Oliver replied. John Saven, Northwest Irrigation Utilities, asked for more detail about agreements that go beyond October 1. The CFAC curtailment goes through January 1, 2002, and the Longview/McCook arrangement extends to April 1, 2002, Oliver replied. Paul Norman of BPA said no other negotiations involve deals that go beyond the current contract period.

The power the DSIs will be returning to the market is worth a billion dollars, and we are hoping to have $300 million to $400 million shared with the region, Oliver went on. The arrangements will help BPA sustain operations in an adverse water year and assure the companies are meeting the interests of affected employees, he explained.

"So your best guess is the smelters wouldn't operate absent these agreements?" asked Marc Sullivan, Northwest Energy Coalition. We did not negotiate on that basis, Oliver clarified. The transactions assure us we will not have to buy power to meet the DSI load through the first winter of the new contracts, he stated.

What is the start date for these transactions? asked Howard Schwartz of the Washington Office of Community, Trade and Economic Development. Some began last November and others started in the past two weeks, Oliver replied. He said BPA is now serving about 500 MW of aluminum load, and the power still flowing is power without remarketing rights.

Tim Stearns of the National Wildlife Federation pointed out that BPA has declared an economic emergency and curtailed the Biological Opinion (BiOp). Oliver said BPA has been aggressive in pursuing options that lessen impacts to the river. "We're facing a disastrous migration season," Stearns said. We are not going to refill reservoirs, he stated, adding that the region needs to come up with a more consistent way of deciding what constitutes an emergency and taking non-essential load off the system. We're facing a critical situation, with between 70 million and 80 million acre-feet (MAF) of runoff and "an absurd" power market, Oliver responded. He said industrial load curtailment would help. Oliver reported that about 800 MW of load is signed up for BPA's demand-exchange program, including 200 MW of non-aluminum load.

Stearns said there has not been enough conservation and cutback in the region's electricity consumption. We have to find a way to get the price signals to customers, he said, adding that the Northwest's political leaders need to get engaged in these issues.

The western governors are meeting in Portland next week, Ken Canon, Industrial Customers of Northwest Utilities, pointed out. He added that conservation is "a tough sell" in the Northwest when California's governor has said he will not raise retail rates in that state. Stearns said the energy package Governor Locke submitted to the legislature is not rational in view of the situation. We have an emergency under the BiOp, and fish interests are considering "whether to throw lawsuits into the middle of the game," he stated. Without effective leadership, the region is heading toward an employment and energy disaster, with "a fish disaster already under way," according to Stearns.

Canon asked BPA to put together a spreadsheet detailing the remarketing and buyback agreements entered to date. Jim Stromberg, CFAC, pointed out some of the information is commercially sensitive. Canon asked for whatever BPA could provide without revealing proprietary information.

Is Our Mission Still Valid?

The study group drew up a multiphase work plan last summer, Adams said. "What we laid out six months ago feels like old news," he stated. It seems it is time to revisit the slate of activities, Adams added. Saven pointed out that when the effort started, the questions were whether the DSIs would survive, what would happen if they didn't, and what people wanted to do about it. I thought it could make sense to do something, if it was not detrimental to my constituents, he said. I don't know if I can say that now, Saven stated, adding there is a question as to whether rural customers can survive in the current power market. I would prefer a broader discussion of the issues, he said.

I agree, stated Peter Forsyth, Kaiser Aluminum. We have viability problems in the region generally, not just with the DSIs, he said. In the current context, we have other huge issues at play, and it doesn't make sense to talk about DSI viability, Forsyth said. The aluminum company study needs to be rechartered as something more broad, Stearns agreed. Our study has been overtaken by the market, he added. Al Link of the Washington State Labor Council said the labor community now faces layoffs in other industries and members are seeing higher energy bills at home. It will take a bigger room to recharter this study, he noted.

The principles we laid out for the DSIs could be transferred to other industries, Adams stated. One option is "to muddle through and let Economics 101 work itself out," or we could ask if there is something we could do collectively that would be more effective than muddling through, he said.

Originally, the issue was limited, but we are now looking at far different market prices, and it's not just a DSI issue, according to Jim Miller, Idaho Power. In time, more resources will come on line, prices will come down, and the load/resource cycle will repeat itself, he said.

How should we be informed by the region in our dealings with the DSIs? Norman asked. We are going to be urged to do things before the new contracts take effect, he said, adding that questions remain about whether to offer contract remarketing rights, to include provisions to buy out load, "or let the chips fall where they may." We thought it would be healthy to have a discussion about what to do about the DSI contracts, Norman said.

Canon asked if the group would act as a sounding board on specific DSI-related issues for BPA. We are going to be facing these choices, Norman responded, indicating he is concerned about making them absent regional input.

Stromberg said the energy situation calls for "political courage," and BPA and the utilities could motivate politicians to look for solutions. We desperately need more resources, he stated. Can we get DSI support for conservation investments? Sullivan asked. You would see DSI support for reasonable additions to the supply portfolio, Stromberg responded. Schwartz noted that Governor Locke's energy package includes supply-side incentives, including incentives for DSIs to self-generate power.

Saven pointed out that some events are within the region's control and others are not. "Why are California folks skating at our expense?" he asked. We can insist BPA decline to provide "another drop of power" until California "gets real," Saven said, adding that his members want to meet with the BPA Administrator to ask why their rates are going up, "while they are screwing around in California."

Paul [Norman] wants feedback on what BPA should do with regard to buying down DSI load in the future, Adams said. Schwartz pointed out the need for an analytic component in considering the options. We need to look at what would leave BPA in the strongest position to deal with a financial crisis, he said. It may be that the best solution is "letting the chips fall where they may," but we should at least consider other things that can be done, Schwartz advised. Someone probably needs to crunch some numbers, he stated.

My impression is there is a willingness to look at a lot of different possibilities, with a focus on BPA's entire load, not just the DSIs, Canon stated. People are questioning BPA's role in system augmentation, and there are suggestions that tiered rates should be considered, he said. With a possible 100 percent rate increase ahead, people are willing to talk about that, Canon added.

Tom Power of the University of Montana said the issue in the aluminum study is how to strategically allocate a scarce resource in a way that benefits the region. When things are booming and energy prices are low, no one is pushed to analyze the assumptions about resource allocation, he pointed out. Power suggested several questions to consider, including whether to let the market play out and allow the region to lose a historic industry, and how such a loss would affect the rest of the Northwest economy.

Saven said another question is whether the country is better off with repayment to the Treasury if the Northwest economy "goes down the tube." He said the region should consider strategies other than the current repayment setup, such as paying a set amount over a five-year period. How about having the Treasury forgive repayment if we transfer power out of the region, Link suggested.

Miller asked whether the group should continue to address the aluminum companies' problems or consider the region's energy crisis. Stearns recommended the group take the opportunity to build a context for the region to frame its choices, "so the politicians can have a common framework to stand on." Our challenge is how to restructure the Northwest market so we make better choices about consumption – we have to reward people for making good choices, he said. Stearns said there would need to be a five-year transition period for the new structure, and he acknowledged there would be winners and losers. The pool of potential losers is larger than before, Sullivan stated. Singling out one of the losers for help "could push others off the cliff," he added.

This group was to address aluminum company issues, stated Joe Piedmont of the Gallatin Group. You have a lot of very valuable and worthwhile information, but it's time to stop for now, he said. Circumstances have moved past you, according to Piedmont. This group could review the questions Paul Norman suggested, he added. A representative of Morgan Stanley indicated there are financial returns to be made from installing turbines in the Northwest. Such turbines could be sited "within the fence" at a DSI, he said. We have a unique opportunity to work with state and local officials to site plants and expedite permitting, he concluded.

What about the idea of using this group as a sounding board? Adams asked. No one seems to be saying, let things fall where they may, he added. I'd vote for that just to keep it on the table, Leone responded. The question is now so much bigger than a single industry that we should get on with the bigger questions, Sullivan advised. Bring on supply and get the demand-side programs going, he said.

I'm hearing a lot of desire for a broader discussion of fixing the market, Norman said. This group was not chartered for that, he added. There is also support for taking a broader look at constraining BPA rates, and that's not what this group is about, Norman continued. Still, we have the question of what BPA should do about its contractual arrangements with the DSIs, he stated. We need a group for that purpose when we are ready to talk about it, but I sense we are not ready yet, Norman said.

That's right, with the governors' meeting coming up and the California governor taking actions, Schwartz agreed. First we need to get a better picture of the regional situation, he added. I hear a strong message that the problem is bigger than the DSIs, attorney Paul Murphy said. There is a shortage, but it's only about 10 percent, he added. If you concentrate on the 10 percent, you may solve the problem, Murphy said.

The participants went over some pros and cons of tiered rates. Brett Wilcox of Golden Northwest said that while an across-the-board rate increase could put a farmer out of business completely, tiered rates might allow for a scaled-back operation. The issue is that some people are bearing part of the market risk and some are bearing none, he said. Marginal prices give the right price signals, Wilcox indicated. BPA is sending a good price signal with a 100 percent rate increase, Leone responded. But that signal is for *all* load – "it's very Draconian," Jack Speer of Alcoa pointed out. Public power looks at tiered rates "with fear and loathing," Leone replied.

How do you view your obligation to serve the DSI load? Miller asked BPA. I don't see that you have an obligation – you have a contract and at the end, the obligation ends, he stated. We've agreed to five-year contracts, but after that, it isn't sorted out, Norman responded. It's not unresolved – after 2006, I won't get service, Wilcox said.

As for the future of this group, we're going to reconvene when the time is right to address some narrow issues of how BPA deals with the DSI contracts, Norman said. If there is a point at which BPA needs to make decisions along those lines, we ought to talk about it, Schwartz stated. Forsyth said there should be a more aggressive and active way for the group to stay involved with the DSI issues.

Economic Studies

Adams pointed out that Terry Morlan of the Northwest Power Planning Council and others worked hard to review and summarize the economic studies provided to the group by various consultants. Canon said the reviewers faced a challenge keeping up with rapid changes in the economic picture, noting they assumed an average DSI rate of 29 mills. It's probably not the best time to give a summary, Morlan said. Schwartz observed that given the results of the analysis, it looks like smelters might be viable in three years. Should we do something to keep the capacity in the region so it can restart in the future? he asked. I'm planning to restart in October – the load won't go away because of the rate increase, Wilcox responded.

There seems to be a feeling that the market situation is a permanent change, Morlan said. I think prices could drop soon with some decent water, he said. Gas prices are likely to go down, too, because of all the drilling that is going on, Morlan stated. The focus should be on how to deal with the short term, using tools like power buybacks, he said.

I'd also urge against making projections about electricity prices far into the future, Power agreed. We just came through a dramatic demonstration of how volatile energy prices can be, he said. When gas prices are low, drilling stops and production shuts down, Power said. Then prices go back up and people flood back into production, he explained. Power suggested the same thing is happening with electricity. But in the past, we didn't have a wholesale market that could put pressure on the situation, he added. "We are in an unusual situation," according to Power. We expect long-term prices to be somewhat higher than in the past, but it won't take too much additional production before prices will plunge again, he continued. And when we have those changes, the utilities' average price will be above market "and people will want to flee again," Power explained. He cautioned against making dramatic "flip-flops" in policy based on current circumstances. This is not the context in which to make long-term decisions, Power said, adding that the industry does need a way of signaling consumers about long-run incremental costs.

Gaylan Prescott of the United Steelworkers said his members are very concerned about what is going to happen to the smelters a year from now. He urged the region to come up with a long-term strategy to keep the industry viable. Don't expect the industry to disappear, Prescott advised. We need a rational discussion about what we are going to do and about allocating resources in a socially responsible way, he said.

Adjourn