

**Kuehn, Ginny - DM**

DSI-001  
FEB 22 2005

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**From:** Arnold.Houg@Alcoa.com  
**Sent:** Tuesday, February 22, 2005 10:36 AM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

Arnie Houg  
Intalco Aluminum-Alcoa  
Arnold.Houg@Alcoa.com  
3603847355

Ferndale wa

I have worked for Intalco for 25 years and appreciate all that the job has done for me and our community and state. I think it would be in everyones interest to include low cost power prices to DSI customers and extend Intalco's request to get a fair price untill 2009. I hope this can be worked out. Thanks -Arnie Houg

DSI-002  
FEB 22 2005

**Kuehn, Ginny - DM**

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**From:** Tia.daulph@alcoa.com  
**Sent:** Tuesday, February 22, 2005 10:56 AM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

Tia Daulph

Tia.daulph@alcoa.com  
360-384-7251  
6767 Figali Ln  
Ferndale Wa 98248

As a federal government agency it should be required that BPA supports the family wage jobs in the region and not reduce possibilities of growth or even survival by limiting the power distribution. DSI's add to the delicate balance needed to have a strong viable region.

2/22/2005

DSI - 003

FEB 23 2005

**Kuehn, Ginny - DM**

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**From:** Terence\_E@comcast.net  
**Sent:** Wednesday, February 23, 2005 12:33 AM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

Terry Easterwood  
Constituent & Intalco Employee  
Terence\_E@comcast.net

2252 Lancaster Way  
Ferndale WA 98248

I support Alcoa's Short-Term Proposal. The proposal is fair, simple, and consistent with arrangements that are in place for other similar industries. Furthermore, the "catastrophic insurance" that is included in the proposal can be a very effective way to protect the interests of all customers in the region from market extremes. BPA should take action that demonstrates complete support of this proposal.

DSI-004  
FEB 23 2005

**Kuehn, Ginny - DM**

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**From:** jim.schon@alcoa.com  
**Sent:** Tuesday, February 22, 2005 5:18 PM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

James  
Intalco Aluminum  
jim.schon@alcoa.com  
360 384-7259  
4050 Mountain View Road  
Ferndale WA 98248

Dear Sirs, I am writing to tell you that the Northwest cannot continue to sacrifice jobs for a few more years of cheap power. Because of high power prices, many jobs are being eliminated. I have seen other plants closed and modernization planned scrapped throughout North America because long-term power was not available. Please do not let this happen in the Northwest. Companies like aluminum smelters can't afford to keep operating. These jobs are important. These jobs support more than just one person; they support entire communities, economies and the entire region. If the power prices from the Bonneville Power Administration continue to stay high, and power allocations low, entire industries like aluminum will be forced to move to a more business friendly environment. That probably means overseas, taking the jobs with them. Without the aluminum industry communities will suffer, businesses will suffer and national defense may even be impacted. Aluminum is a strategic defense material. We need a domestic supply of this material. We need to take a different approach to allocating federal hydropower. An approach that doesn't mean sacrificing jobs. There's got to be a better way. I know of these issues first hand as I just got back to the Northwest from a four year stint in Louisiana due to a facility closure in the Northwest. I was offered a chance to relocate to the Intalco facility in Ferndale Washington and I took that opportunity with the hopes that my job will not again be sacrificed due to long term power issues. The Northwest is a beautiful place to be and work! I love it here and want to stay! Sincerely, James E. Schon Environmental Manager Alcoa Intalco Works

February 12, 2005

DSI-005  
FEB 28 2005

Bonneville Power Administration  
P.O. Box 14428  
Portland OR 97293-4428

Gentlemen:

**Direct service Industries Open Forum**

Thank you for accepting comments on the Forum scheduled for March 1, 2005.

Using Panels to cover various subjects in BPA's straw proposal is good organization for a one -day meeting. But, it is not clear that what I consider to be the number one question for preference customers will get consideration. That is, how does the proposal handle the future issue of allocation of the capability of the Federal Base System.

Back in the days of Don Hodel's Notice of Insufficiency and letter to Frank Ivancie, then Mayor of Portland, it launched a major scramble among preference customers to develop a plan of allocation. It was big vs small, irrigations vs industrial, generators vs non-generators, new customers vs old. BPA and those that worked hard on the problem found out that the only solution was more resources.

One of the controlling issues against two tier rates is the need to allocate the Base System.

Not to dwell on the past for too long, we must accept the need to allocate the Base System probably sometime in the period 2007-2011.

The straw proposal is not a new idea. Some of us discussed the proposal of serving the DSI load through a local utility a number of years ago. The DSIs had two problems: (1) The local utility would have to have firm service (wheeling) rights over BPA facilities and BPA would have to continue to operate ,maintain , and replace the substantial BPA facilities involed.plus provide the metering facilities. Under BPA policies and rules and past practices, BPA would charge the local utility for such services.for delivery at 13.8kv.This cost would have to be included in the margin of the local utility: and (2) The local utility would also have to include in its margin the cost of the State of Washington's utility tax which for the DSIs is a substantial amount. At that time the DSIs dropped the local utility plan.

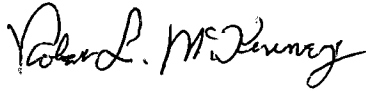
In the scheduled Forum, I hope that there is a full discussion of these matters. Is there a hidden agenda for shaping the the BPA power such as calling it surplus or interruptible and thus waive the application of local utility service at 13.8 kv? Is there any plan of the DSIs to lobby the Washington State Legislature to waive the utility tax applicable to the local utility as their part of the package to save family wage jobs?

When it becomes time for the allocation of the Base System. Will the preference customers be giving up their lawful right to 500aMW of Tier 1 power and forever (at least 20 years) be paying for Tier 2 power?

One last point: The Assignment protection on resale rights was a complete failure in the case of Reynolds-Alcoa-Longview Aluminum. Does BPA have better legal council?

For the Public Agencies: Remember Paul Raver's advice, "The only time that a Public Agency can challenge a BPA contract with a DSI is at the time that BPA enters into the contract"

Thank you for your consideration.



Robert L. McKinney  
(360) 423-8529  
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Robert L. McKinney  
2326 Cascade Way  
Longview, WA 98632-5508

DSI - 006  
FEB 25 2005

**Kuehn, Ginny - DM**

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**From:** joedady\_3@juno.com  
**Sent:** Wednesday, February 23, 2005 10:08 PM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

L. Engler  
Alcoa Intalco Works  
joedady\_3@juno.com  
360 384-0324  
6206 Gadwa Rd  
Ferndale Wa. 98248

I am an employee at Alcoa Intalco Works. I have a wife and three children. As a 27 year employee, I have enjoyed the benefit of having a job because of reasonable priced power. I understand that many jobs in the state of Washington are contingent on the price of power between 2006 and 2011. If we are to keep jobs in Washington State and remain globally competitive we need the cheapest power possible. As we are entering the comment stage of rate regulations for DSI customers, please keep the electric rates low for all, so that we can keep America Working. For each well-paid job, seven other jobs are created. This correlates to a strong, healthy, and happy America. Thank you.

**Kuehn,Ginny - DM**

DSI-007  
FEB 25 2005

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**From:** scott.uren@hwr.com  
**Sent:** Thursday, February 24, 2005 5:29 PM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

**Comment on Additional Comments on BPA Service to DSI Customers**

View open comment periods on <http://www.bpa.gov/comment>

Scott Uren  
Harbison Walker Refractories  
scott.uren@hwr.com  
360-866-3513  
2333 Island Dr  
Olympia WA 98502

Please accept Alcoas proposal. As one of the last remaining aluminum producers in our area, they are also the most efficient. They also employ and contribute to our employment base in Washington, and have been recognized as "Good Corporate Citizens"..as a refractory supplier to this industry ( also one of the last remaining) I know the industry well, and respect these folks for all they have done during a very turbulent last 5 years.. Whether a Republican or Democrat, keeping these plants open is a good thing..Raising their rates won't make up for the revenue lost on the other closed plants due to high rates and the Enron fiasco..Give them good rates, give Evergreen aluminum the same deal. Your base will increase as well as your revenues !



DSI-008

FEB 25 2005

**Kuehn,Ginny - DM**

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**Sent:** Friday, February 25, 2005 12:25 AM

**To:** BPA Public Involvement

**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**

View open comment periods on <http://www.bpa.gov/comment>

Dennis Van Beek  
Alcoa Intalco Works  
Dennis.VanBeek@alcoa .com  
360-384-7301  
2929 Arnie Rd  
Custer Wa 98240

Greetings, it is imperative that BPA provides a long term low cost contract to Northwest Alcoa smelters and to continue providing DSI industries with allocated power that has been established originally for Northwest aluminum smelters. Many advantages will be accomplished with the latest proposal by Alcoa to sustain a viable Northwest economy in providing good family wage jobs. We must find solutions in cutting overhead costs to continue to keep the Northwest economy alive. Alcoa provides the much needed tax base and also provides many secondary jobs that keeps the Northwest economy healthy. We must do everything possible to sustain blue collar employment and keep the incentives alive in order for Alcoa to stay competitive and continue to do business in this great state we live in. As a personal power consumer I am willing to accept a rate increase to keep the local economy alive and not risk suffering the consequences of Alcoa shutting down operations and having a very negative effect on this region that will affect everyone as rate payers. Please offer a much needed solution for low cost power to Alcoa to keep us alive and get on with getting back to full production long term contract to stay on the competitive Global cost curve. Thank You! Mr. Van Beek

DSI-009  
FEB 25 2005

**Kuehn,Ginny - DM**

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**From:** catscanf@peoplepc.com  
**Sent:** Friday, February 25, 2005 1:37 PM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

Terry G. Fischer

catscanf@peoplepc.com  
360-676-8210  
915 Sudden Valley  
Bellingham WA. 98229

I agree that you are moving in the right direction with your latest proposal for the DSI's. I wonder where all that power is now going that the now curtailed or shut down Industries were using before the power crisis. I think that the responsible DSI's deserve the right to get back to their original capacities with affordable power if it brings more jobs to the state and promotes our economic growth overall. Thank You, The Fischer Family

DSI-010  
FEB 28 2005

**Kuehn, Ginny - DM**

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**From:** Bruce.Stadt@alcoa.com  
**Sent:** Monday, February 28, 2005 7:00 AM  
**To:** BPA Public Involvement  
**Subject:** Comment on Additional Comments on BPA Service to DSI Customers

Comment on **Additional Comments on BPA Service to DSI Customers**  
View open comment periods on <http://www.bpa.gov/comment>

Bruce Stadt  
Alcoa Intalco Works  
Bruce.Stadt@alcoa.com  
360-384-7507  
4050 Mt. View Rd.  
Ferndale WA 98248

Dear BPA, I am writing you to Please think about the impact to families in this region that will be affected if the proposed service to the DSI's goes into affect. We need these family wage jobs that the DSI's provide to the economy in this area to keep going. Please rethink your proposal and keep jobs for myself and many others who enjoy living and raising my family here. Thanks, Bruce Stadt

DSI-011  
FEB 28 2005

**Kuehn,Ginny - DM**

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**From:** Paul M. Murphy [pmurphy@mblp.com]  
**Sent:** Monday, February 28, 2005 11:37 AM  
**To:** Norman,Paul E - P; BPA Public Involvement  
**Cc:** Oliver,Stephen R - PT; Wilson,Scott K - PS; Clark,Harry W - PTS; Brett Wilcox (E-mail); Gerald F. Miller (E-mail)  
**Subject:** Golden Northwest Aluminum's Comments to BPA's Post-2006 Proposal for DSI Service

Paul,

Brett is tied up in hearings in the GNA bankruptcy today, and he asked me to send you GNA's comments to BPA's straw proposal regarding service to DSIs in the FY 2007-11 period in advance of the open forum tomorrow. I have attached those comments hereto. Brett intends to attend the forum tomorrow and I assume that he will be participating in panel 3 at that time. I am sure he will be happy to answer any questions about GNA's comments that you may have.

***Paul M. Murphy***  
**Murphy & Buchal LLP**  
2000 SW First Ave., Suite 320  
Portland OR, 97201  
Tel: (503) 227-1011  
Fax: (503) 227-1034  
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2/28/2005

February 28, 2005

DSI-011  
FEB 28 2005

Paul Norman  
Senior Vice President - Power Business Line  
Bonneville Power Administration  
P.O. Box 3621  
Routing: P-6  
Portland, OR 97208-3621

Re: BPA Service to DSIs during FY 2007-11

Dear Mr. Norman:

These comments are submitted on behalf of Golden Northwest Aluminum, Inc. ("GNA") in response to your letter of February 4, 2005 regarding service to direct service industry ("DSI") customers during the 2007-11 period. We greatly appreciate the opportunity to submit our view on the issues.

GNA agrees entirely with BPA that the appropriate focus of BPA's proposal to continue some level of power benefits to DSIs into the FY 2007-11 period should be to sustain DSI jobs in the Pacific Northwest, and in particular, jobs in the isolated rural communities where most of the remaining DSIs operate. Many in the region appear to have forgotten, or perhaps they never realized, the crucial role that sales to the DSIs played in allowing the region to develop the hydro-electric potential of the Columbia River system at a relatively low nominal cost. We are pleased that BPA's institutional memory is not so short. We were also pleased that BPA did not endorse the incorrect assertions of some utilities that it was the intent of the Pacific Northwest Power Planning and Conservation Act (Regional Act) that BPA offer the DSIs only a single 20-year contract, during which time the DSIs were supposedly to make alternative power supply arrangements. As we pointed out in prior comments, the DSIs were crucial to the successful development of Federal Columbia River Power System, and the Regional Act was designed to assure an economical power supply for the entire region, including DSIs, for the indefinite future. Indeed, the Regional Act was premised on the assumption that BPA would continue to provide full service to its DSI customers into the foreseeable future<sup>1</sup>. It would be grossly unfair to the DSIs, their workers and the communities in which they operate for BPA to discontinue all service to the DSIs when the term of their current contracts expire.

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<sup>1</sup> GNA and Alcoa submitted a detailed discussion of these issues to BPA and the NWPPC on September 12, 2002. A copy of that "Discussion Paper on BPA Options for Post-2006 Policies on the Sale of Federal Power" is enclosed herewith and made part of these comments.

## Summary

GNA believes BPA should offer to serve the net requirements needed to support full operations of its current DSI customers. Alternatively, BPA should offer to extend service at the current contract amounts through FY 2011. However, GNA recognizes the current political realities, and can support an offer by BPA of the equivalent of 500 aMW per year of power priced at BPA's average cost (*i.e.* the flat PF rate) or the financial equivalent of such power to be made available to all DSIs in proportion to the amount of power they actually consume each month in their operations. By making power available in proportion to actual operations in the FY 2007-11 period, BPA would target the available power system benefits exclusively to DSIs that demonstrate their viability and job sustaining capability by actually operating. It avoids having BPA itself create the winners and losers among smelters by favoring some companies with benefits while denying benefits to others. This proposal also has greater job creating potential because, unlike BPA's straw proposal, the available benefits are not concentrated in the hands of a favored few.

If BPA insists on deciding in advance which smelters will be given access to power system benefits, BPA should not rely for this purpose on which smelters happen to be operating now. Whether particular smelters are or are not currently operating is a function of each company's unique current circumstances, which do not reflect smelter viability in the FY 2007-11 period. Any advance allocation of power should be based on a detailed analysis of actual operating characteristics of the smelters using company supplied and verifiable smelter specific data.

## Background

### 1. The Smelters

GNA owns, through subsidiaries, two primary aluminum smelters and associated equipment in the Region. These smelters convert alumina ore into aluminum metal in an electrochemical process. Both smelters are direct service industrial facilities within the meaning of the Regional Act, so BPA is authorized by law to sell power for use at the smelters. 16 U.S.C. § 839c(d)(1)(A).

The Goldendale smelter in Klickitat County Washington is located on 7,000 acres with all the buildings, equipment, utilities, infrastructure and other fixed assets needed to produce over 168,000 metric tons of aluminum per year with a gross electric consumption of about 327 a MW. It contains three cell lines with a total 526 of vertical stud Soderberg reduction cells. It is the newest smelter in the Region, generally is recognized as the most efficient Soderberg smelter in the world, and has operating efficiencies that can compete with newer pre-bake smelters. Between 1990 and 1999, Goldendale operated at an average of 117,000 amps consuming 6.85 kilowatt-hours of electricity and 0.49 pounds of carbon per pound of primary aluminum produced.

The Dalles Smelter is located on 490 acres in The Dalles, Oregon and has all of the buildings, equipment, utilities and infrastructure and other fixed assets needed to produce 82,000 metric tons of aluminum per year with a gross electric consumption of about 169 a MW. It has 300 vertical stud Soderberg reduction cells arranged in two cell

lines. Between 1990 and 1999 The Dalles operated at 108,000 amps, consuming 7.2 kilowatt-hours of electricity and 0.50 pounds of carbon per pound of primary aluminum produced. While The Dalles is not as efficient as Goldendale, its efficiencies compare favorably with many smelters.

Each smelter is self sufficient with its own carbon paste plant, cast house, maintenance, utility and other facilities to support the smelter operations.

In recent years, GNA has invested substantial sums at its two smelters to improve their efficiency, productive capacity and value of the products produced. The cast house at Goldendale was commissioned in 1971, it was expanded in 1983 and was expanded and modernized in 1999, with new state-of-the-art equipment to produce world-class billet for the automotive and other premium markets. The cast house at The Dalles has been expanded, and is now capable of casting the entire output of the smelter into value-added extrusion billet. The capability of both smelters to cast almost all of their production in extrusion billet and other value-added products significantly improves their economic viability.

Since 2000, the Goldendale Smelter has developed and demonstrated new technology and operating procedures that allow it to increase amperage and metal production by 20% while maintaining its high level of electric and carbon consumption efficiency. The same technology and practices can be implemented at The Dalles smelter to increase amperage and production by 12% and improve energy efficiency to about 7.0 kWh per pound.

## **2. History of BPA Service to GNA**

BPA is authorized to sell up to 327 aMW (the contract demand under the 1981 contract as increased from time-to-time by BPA approved "technological allowances") for the Goldendale smelter in Klickitat County, Washington, and it is authorized to sell up to 169 aMW for the Northwest smelter in The Dalles, Oregon. Since 1971 in the case of Goldendale and since 1958 in the case of The Dalles, these facilities have operated as DSI customers of BPA either exclusively or primarily using federal power. Taking into account the lower quality of service generally provided to the smelters (*i.e.* the greater exposure to periodic power interruption to support service to other customers), they have paid power rates that were as high or higher than those paid by BPA's other customers. They are both located within the service territories of PUD customers of BPA. Therefore, but for the benefits that BPA obtained by serving the smelters directly instead of through the local public utilities in whose territory the smelters are located, both smelters would have been part of the utility load that BPA is obligated to serve at its lowest cost-based rate. Thus, there is no equitable reason to discriminate against the smelters just to hold down rates to other BPA customers, including rates to industries served indirectly by BPA through local utilities.

Other than factors relating to the convenience to BPA, the smelters are indistinguishable from other indigenous industry, except for the size of their electrical load. For that reason, GNA has long accepted the proposal made by the Joint Customer group that BPA should target the load to be served for each smelter to 100 MW on average (subject to allowing the owner of multiple smelters the freedom to allocate

among its smelters to achieve reasonable operations consistent with the characteristics of each smelter)<sup>2</sup>. This level of service is comparable to the larger industrial loads served indirectly by BPA through local preference utilities. Inasmuch as there are now five smelters in the Pacific Northwest that have continually maintained substantial power contracts with BPA and six that are physically capable of producing aluminum, GNA supports BPA's proposal to make 500 MW of federal power (or 600 MW if the Evergreen smelter is included) available to such smelters at a rate equivalent to the PF rate. GNA does not, however, support BPA's "eligibility criteria", or indeed, the basic concept of BPA picking in advance who will be the winners and losers among BPA's DSI customers.

### **3. Market Factors Affecting Smelter Operations.**

Primary aluminum is a commodity, so aluminum smelters do not directly compete with each other. Instead, aluminum smelters sell into the same commodity market and compete by trying to keep their total operating costs below the market price for primary aluminum, typically represented by the price for financial transactions as quoted by the London Metals Exchange ("LME"). Aluminum production costs are driven primarily by alumina ore, power and other conversion costs (labor, anode carbon, cathode blocks, electrolytic bath, operating efficiencies, etc.).

Primary aluminum for physical delivery to end use customers commands a premium of 2 to 6 cents per pound (reflecting transportation and finance costs) above the LME price. Alloyed aluminum cast house products also earn a premium above the price of primary aluminum on the LME. In addition to the typical premium for delivery of physical metal, standard extrusion billet typically commands a gross margin of 6 to 10 cents/pound more than primary aluminum. The Goldendale Smelter and the Dalles Smelter can cast most of their production in the form of extrusion billet and earn a significant additional net profit on each pound of billet produced.

Alumina ore, carbon, and electrolytes for bath are themselves commodities and, other than differences in transportation costs, smelters generally face the same actual or opportunity cost for these inputs. Because alumina ore is a commodity and the amount of alumina required per unit of aluminum is fixed as a matter of physics, the competitiveness of different primary aluminum smelters is determined by two factors: power rates and other conversion costs. In general, the Goldendale Smelter and the Dalles Smelter are competitive in labor, anode carbon, cathode, operating efficiencies and other conversion costs. Indeed, both Smelters are among the best in the United States and better than average on a worldwide basis in terms of conversion costs, excluding electric power costs.

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<sup>2</sup> The practical minimum operating level for GNA's two smelters is one out of three lines at Goldendale, or roughly 109MW of smelter load, and one of the two lines at The Dalles, or roughly 85 MW of smelter load. A 200 MW contract with BPA would allow GNA to maintain these minimums. However, depending on circumstances, it might well make more sense for GNA to shift all of its production to Goldendale to maximize efficiency if there were an extended slump in the market for primary aluminum.



Excluding alumina<sup>3</sup>, electricity is the single largest costs of producing aluminum, and it is the cost that varies most significantly among smelters. The average price for power to the world's aluminum industry is generally believed to be a little below \$20 per MWhr. Current prevailing power prices in the Northwest place this region in the highest 10% of electricity prices facing smelters in the world. At these prevailing prices, smelters in the Pacific Northwest can operate competitively only if aluminum prices are very high. Thus, the key to restoring competitiveness for GNA's smelters is to reduce their power cost.

## Evaluation Of BPA's Proposal

### 1. Level of Benefits

BPA proposes to offer 500 aMW of power system benefits to DSIs. GNA believes that BPA should offer to meet the full net requirement of its DSI customers at a rate tied to the PF rate, both as a matter of fundamental fairness and to be consistent with the intent and structure of the Regional Act. At a minimum, BPA should offer to extend service to each DSI at its current contract amount through FY 2011. We recognize, however, the political realities and BPA's strong preference for some form of financial benefit *in lieu* of actual power sales so as to cap BPA's cost exposure and limit its risks. There are now only five smelters in the region that are both physically capable of operating and hold current contracts with BPA of at least 100 MW per smelter. Based on these factors, GNA can accept a properly structured proposal for BPA to provide service benefits equivalent to 500 aMW of power at BPA's average cost. This amount of power system benefits should allow each smelter to maintain at least some sustainable level of operations, and may, under the right circumstances allow for substantially more operations.

BPA should not, however, cap the "cost" of benefits at \$40 million. BPA should offer 500 aMW of power at BPA's average cost (presumably the PF rate) or offer financial support that is truly equivalent to 500 aMW of power. If, for example, BPA were to forecast that the average market price of power for the FY 2007-11 period would be \$45/MWhr and the PF rate were \$27 MWhr, then a level of financial support equivalent to 500 aMW of power would be closer to \$80 million than to \$40 million. While some utilities may argue that this results in about a \$1 MWhr increase in BPA's average rate, it is appropriate to recognize that the decrease in DSI contract loads from 1486 MW for the current contract period to 500 aMW represents a \$2 MWhr reduction in BPA's average rate. Unless BPA plans to discriminate unfairly among the smelters, 500 aMW is a practical minimum level of power benefits to offer to DSIs.

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<sup>3</sup> Historically, alumina ore has been priced either at a fixed price per metric ton or at a variable price of 12-13% of the LME price per ton of aluminum. It takes about 1.94 tons of alumina to produce one ton of primary aluminum, so the cost of alumina typically represented about 25% of the LME price of aluminum. Recently, as described later in the text, the market price of alumina has soared to over two to three times its normal price and at times has represented 50-60% of the total cost of primary aluminum.

## 2. Eligibility Criteria

BPA has stated that the “eligibility criteria” (*i.e.* the factors that will determine to which smelters BPA will offer or deny power system benefits) in its straw proposal center on 1) credit worthiness and, 2) evidence of each DSI’s ability to operate and create employment in the future (“viability”). BPA also apparently intends to judge each DSI’s credit worthiness and viability primarily by looking at the recent past (*i.e.* the current contract period). GNA strongly disagrees with this element of BPA’s proposal. As proposed, the “eligibility criteria” appear to have been structured to favor specific companies instead of focusing on expected viability of smelters in the FY 2007-11 period.

### ***The recent past is not a valid predictor of viability.***

Circumstances in this current contract period are not at all predictive of what will happen in the FY 2007-2001 period. The last five years have been characterized by extreme volatility and change in many of the markets that affect aluminum production in the Northwest and competition in worldwide aluminum markets. Electricity prices soared to historic highs in 2000 and 2001, collapsed in 2002, and now, driven by high gas prices, persist at a higher level than most industry experts believe is sustainable.

During this same period, alumina ore prices rose to over \$600 per metric ton, or 30% of the price of aluminum, (significantly above the historic average of about \$170 per metric ton, or about 12%-13% of aluminum prices), because China added large and unexpected smelter capacity without there being any corresponding increase in alumina production. Producers are expanding existing alumina refining capacity and bringing on new capacity as fast as possible to take advantage of the huge profit potential in alumina production, and prices are expected to decline to or below the long-term cost of production (reportedly \$75-200 per ton) within the next couple of years.

Also, the dollar has declined significantly in value against most world currencies. This development tends to improve significantly the competitive position of aluminum smelters in the United States by reducing the cost of labor, electricity, carbon and other inputs to aluminum production purchased with dollars in the local markets, relative to similar costs of smelters operating in other parts of the world. These changing circumstances will affect the Pacific Northwest smelters in various, and not necessarily predictable ways, and make the recent past a weak predictor of the viability of smelters going forward.

The lack of predictive value of the recent past is particularly significant in the case of GNA. GNA is in the final stages of reorganization under the bankruptcy code and expects confirmation of its plan of reorganization within a week. The heavy debt load that contributed to GNA’s recent difficulties will have largely been converted to equity, thus reducing GNA’s interest obligations by about 90%. GNA’s new majority owners are strong, very credit worthy entities. Moreover, the different choices made by

the various companies on how to spend their remarketing proceeds<sup>4</sup> and for what period to allow BPA to buy-back their contract power under the current contracts substantially affected GNA in the 2002-2006 period, but they will not be factors in 2007-11. The smelters that are, or are not, currently operating are based on each company's unique current circumstances and do not reflect basic viability in the 2007-11 period.

***Power costs swamp other differences among the smelters.***

BPA's "eligibility criteria" ignore the dominant role power cost plays in smelter viability. The six smelters that have not been dismantled or closed permanently are all physically viable to operate, and they are all economically viable under the right conditions. The cost of power each smelter will face is by far the most important condition once alumina markets stabilize (almost certainly to have occurred by FY 2007). Any significant difference in the cost of power among the smelters would have a far greater affect on the relative viability of the smelters than would all other differences among the smelters combined. If BPA determines in advance to which smelters it will provide power system benefits and how it will allocate the available benefits among the favored smelters, BPA will cause, not just forecast, the success or failure of these smelters. Choosing which smelters should succeed or fail and which communities must suffer the attendant economic dislocation is not an appropriate role for BPA.

**GNA's Proposal**

**1. BPA Need Not And Should Not Attempt To Predict Viability.**

Importantly, there is no reason for BPA to attempt to predict in advance based on viability which smelters to support and which to reject. BPA need only specify the amount of power system benefits it will make available to support actual smelter operations, and provide those benefits to those smelters that do operate in proportion to their actual level of operations. That way, BPA would not be engaged in tilting the playing field among its smelter customers, potentially causing some to fail that could otherwise survive and provide jobs in their community. An error of this type would be particularly tragic in Klickitat County, Washington, a very depressed area uniquely dependent on jobs at the Goldendale smelter.

GNA strongly recommends that BPA determine the specific level of benefits it will provide to assist smelter operations, known and capped to meet the expectation of other customers. However, the "eligibility criteria" should be limited to BPA's proposed principle number 3, as follows:

"The power or financial benefit will only be provided in support of actual DSI operations and employment, and the DSI must be purchasing and consuming an amount of power in support of production operations to receive any Federal Columbia River Power System ("FCRPS") benefits."

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<sup>4</sup> GNA alone among the DSIs invested a substantial portion of its remarketing proceeds in an effort to secure a long-term power supply. The choice to invest for the long term substantially reduced GNA's ability to simply hunker down, as did other DSIs, and none of GNA's proceeds were used to purchase contract power from BPA.

## 2. Mechanics Of GNA's Proposal.

We propose that the amount of benefits provided to any smelter be pro-rata, based on the actual amount of power purchased by the smelter at a price in excess of the PF rate for its operations. The benefits to each smelter should also be constrained by the total capped amount of benefit available to all smelters combined, and by BPA's proposed principal number 1 that no power sale or financial payment in lieu of a power sale would be provided where such payment would cause a DSI's net cost of power to drop below the flat PF rate equivalent.

The following is a brief description of how this proposal could work (assuming financial payments *in lieu* of a power sale):

1. During the FY 2007-11 period, each month each DSI operating a smelter would submit to BPA power invoices or other evidence, as determined by BPA, of operating level and power cost for the prior month
2. BPA would then determine the level of financial support per megawatt-hour needed that month to reduce the actual net power cost for all smelters to the level of the flat PF rate.
3. If the total benefit needed to reduce all supported power purchases (*i.e.* total purchases at prices in excess of the PF rate) of all operating smelters to the flat PF rate level is equal to or less than total financial benefits available for that month, then BPA would simply issue the benefit checks to DSIs that were operating to reduce their effective power cost to the flat PF rate level.
4. If the amount of benefit available for the month is less than the amount that would be required to achieve a flat PF rate equivalent power cost for all operating smelters, then BPA would issue benefit checks that in aggregate were equal to the monthly amount available, and in amount pro-rata to each DSI based on each DSI's total supported power consumption.

This proposal eliminates any need for BPA to concern itself with creditworthiness. It also assures that 1) all benefits are targeted to support operating smelters; 2) it allows actual facts to determine which smelters are viable to operate instead of having BPA pick which ones will be allowed to operate by "choosing" which are deemed viable in advance; and 3) it adjusts automatically the benefits per unit of production up or down to the extent that factors in markets for aluminum, alumina and other inputs to aluminum production make financial support more or less crucial to smelter operation.

This third factor operates with respect to power costs, because the effective cost of power would never fall below the flat PF rate, so if power costs decline substantially, the per kilowatt benefit level declines, but more kilowatt hours can be supported. It operates with respect to other relevant markets because, if aluminum prices rise substantially or the cost of other in-puts decrease, the over all level of aluminum

production will tend to increase and the per unit benefit level will tend to decrease correspondently. Therefore, an allocation based on actual production levels can spread to new production and will leverage the job creation potential of any level of benefits in a manner not possible with an allocation determined in advance. GNA's proposal is more fair, more efficient and frankly more prudent for BPA, than is any proposal that has the appearance, if not the reality, of BPA creating (as opposed to identifying) winners and losers through its "eligibility criteria".

### **3. GNA's Proposal Is Superior To BPA's For Supporting Jobs.**

The proposal outlined above will support at least as many, and probably more, smelter jobs than would the alternative of BPA selecting (or creating) winners and losers in advance. Each smelter in the Pacific Northwest conceptually must fall into one of three categories: 1) smelters that are "not-viable" under most if not all foreseeable power and aluminum price scenarios; 2) marginal or "swing smelters" that could operate only during periods of relatively high foreseeable aluminum prices or relatively low foreseeable power costs or some combination of the two and; 3) "non-marginal" smelters whose operating characteristics will almost certainly support essentially full operations over most or all of the foreseeable range of power costs and aluminum prices once the alumina ore market stabilizes within normal price ranges (probably before the end of 2006).

Under both BPA's straw proposal and the alternative GNA proposal outlined above, the power system benefits reasonably available to BPA will not affect the operation of smelters in the first, "not-viable" category. Presumably BPA would exclude such smelters from benefits under its eligibility criteria, and if they are not viable and do not operate, they would receive no benefits under GNA's proposal.

For smelters in the second, marginal or swing category, power system benefits would be highly relevant to operating levels under the broad mid-range of foreseeable power and aluminum price scenarios. More importantly, power system benefits are likely to permit a swing smelter to maintain a minimum viable level of production under virtually all conditions. Power system benefits that reach this category of smelters will have by far the greatest job creation value. Jobs associated with the constant minimum operational level made possible by the power system benefits will be marginal jobs, in the sense that they will only exist with such benefits. By maintaining this minimum or "pilot light" level of operations, the smelter will be able to retain a core group of skilled labor to rapidly add production when economic conditions are favorable, thus providing substantial leverage in job creation and sustainability from the regions investment in power system benefits. Additional job creation leverage is created by the fact the benefits can be spread more broadly when economic conditions favor aluminum production to help bring additional swing capacity on line.

This swing category is the category in which BPA's *a priori* eligibility criteria are most likely to misjudge and fail to accommodate the true job creation potential of BPA continuing service to DSIs. At best (but unlikely), under its proposal, BPA will have perfect foresight and allocate the optimum percentage of benefits to each of the swing smelters. But if BPA's foresight is less than perfect, BPA could eliminate a swing smelter that would otherwise run, putting a greater percentage of the benefits into the

non-marginal smelter and foregoing the leverage of helping more swing capacity to ramp-up during favorable conditions.

Any power system benefits directed to the third category of non-marginal smelters will not create or sustain jobs. Such a smelter will operate with or without the power system benefits, and the benefits will serve primarily to improve the smelters bottom line. Although GNA's proposal and BPA's proposal both would allow benefits to flow to such a smelter, BPA's proposal is likely to target a greater percentage of benefits to this third category and less to the swing category where the benefits really pay off in jobs.

### **GNA's "Second Best" Allocation Proposal**

#### **1. Allocation Of Benefits.**

Other companies may argue that GNA's proposal fails to provide them with the certainty they need for the FY 2007-11 period. Certainty is of some value, but in truth, no matter what BPA decides with respect to the allocation of power system benefits, there can be no certainty regarding a number of factors that will affect aluminum production during the contract period. GNA believes that the value of preventing BPA from causing the demise of a smelter that would otherwise operate outweighs the value of each company knowing the exact level of power system benefits it will have available.

If BPA concludes that it must specify the amount of power system benefits to be offered to each smelter in advance, then GNA believes that 100 aMW per smelter would be the best allocation, so as to support some level of operations by each company. Alternatively, BPA could allocate the power based on the total power load of each company that is not already covered by low cost resources.

#### **2. If BPA Uses A *Priori* Eligibility Criteria, It Must Rely On Reliable Data.**

If BPA decides to utilize some form of a *priori* allocation, it would certainly not be appropriate to rely on creditworthiness and actual smelter operations in the FY 2002-06 contract period to determine eligibility. As noted above, GNA's creditworthiness will change dramatically as a result of its reorganization in bankruptcy, and the factor that most contributed to differences in operations in FY 2002-06, *i.e.* the choices the companies made on how to deploy remarketing and buy-back proceeds, will no longer affect the FY 2007-11 period. Quite frankly, the "eligibility criteria" alluded to in BPA's letter of February 4, which relate exclusively to creditworthiness and purchases from BPA in the FY 2002-06 period, appear to be designed to exclude GNA from access to power system benefits without so stating. They shed little or no light on future viability and bear no relationship to the potential for job creation.

Instead, if BPA wishes to make predictions about which smelter will operate if offered power system benefits, BPA should collect from the smelter actual operating costs, production levels and product mix data to evaluate where power system benefits are likely to have the greatest affect on jobs. GNA is confident that its costs and operating margins for the products it can produce are comparable to or better than other smelters in the Pacific Northwest. GNA is prepared to provide to BPA detailed data to

BPA to demonstrate its viability if BPA is willing to rely on such data from all smelters to determine eligibility.

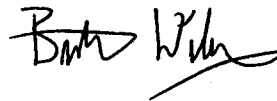
Just as it would be inappropriate to rely primarily on events in the FY 2002-06 period to predict future viability, it would also be inappropriate to rely solely on generally available published reports for actual smelter specific data. Published reports of smelter costs are only approximations of relative smelter cost, and they often rely on fairly crude approximations that can distort matters. For example, while total power costs may be known for most of the world's smelters, the actual production of aluminum and the product mix at each smelter are often not accurately reflected in such reports. Thus, a smelter that has a significant casting operation, with electric furnaces, may appear to have a lower overall electric efficiency than a smelter that produces only primary ingot. But, the casting operation will generally generate greater margins than the pure smelting operation, and may be a much more viable plant. If BPA is going to judge which smelters will succeed and which will fail, then it must judge based on actual and reliable data.

### **Conclusion**

Given the number of potentially viable smelters in the Pacific Northwest and their importance to the economic health of the communities in which they are located, power system benefits equivalent to 500 aMW of power priced at BPA's average cost is the minimum acceptable benefit level. GNA should be eligible for a share of such benefits in proportion to its actual power consumption in the FY 2007-11 period. BPA should not adopt "eligibility criteria" designed to exclude GNA from benefits in favor of other companies that BPA arbitrarily deems viable and that might operate anyway without any benefits.

Thank you very much for providing GNA this opportunity to comment on BPA's proposal.

Sincerely,



Brett Wilcox  
President and CEO

cc: comment@bpa.gov

FEB 9 2 2005

**DISCUSSION PAPER ON BPA'S OPTIONS FOR  
POST-2006 POLICES ON THE SALE OF FEDERAL POWER**

**September 12, 2002**

**Alcoa Inc.**

**Golden Northwest Aluminum, Inc.**

On June 19, 2002, the Bonneville Power Administration (BPA) and the Northwest Power Planning Council (NWPPC) asked interested parties in the region to comment on how BPA should market power and distribute the costs and benefits of the Federal Columbia River Power System (FCRPS) in the Region after 2006. Alcoa Inc. and Golden Northwest Aluminum, Inc., both of which are also submitting individual comments, submit these comments jointly. BPA stated that it would apply five principles to evaluating suggestions submitted by stakeholders. Two of the principles are the focus of these comments: that the policy options not require legislative change and should minimize legal risk (*i.e.* they be within the letter and spirit of BPA's legislative authority); and that whatever option is selected, it should create clarity regarding BPA's load obligations after 2006.

**Executive Summary**

**The Regional Act Makes Service to BPA's Three Customer Classes  
(Publics, IOU Residentials and DSIs) Mutually Interdependent**

The Pacific Northwest Power Planning and Conservation Act (Regional Act), 16 U.S.C. § 839 *et. seq.*, was designed to provide all customers within the Pacific Northwest the ability to purchase Federal power from BPA. The expectation that all customers would obtain service from BPA was so embedded in the Act that the Residential Exchange program, the sole lawful means for BPA to provide wholesale rate parity for residential and small farm customers of investor-owned utilities (IOUs), cannot be made to work under the law unless BPA continues to serve its direct service industrial (DSI) customers. The reason that the Residential Exchange program is wholly dependent on service to the DSIs is that the Regional Act prohibits BPA from collecting from public agency customers the costs of the program.

- Early advocates of Federal development of the hydroelectric capabilities of the Columbia River System recognized that industrial sales were key to the financial success of the Federal hydro projects. The DSIs have been significant customers of BPA since its inception. Power sales to the DSIs allowed BPA to pay for the Federal Power system in a way that it could not have done without the DSIs. (Point I)
- BPA and the Federal electrical facilities have played a key role in the integrated power system for the Pacific Northwest by developing a regional transmission system and coordinated planning of Columbia River operations to carry out responsibilities under the Canadian Treaty. Service of DSIs by a regional BPA



instead of by local utilities contributed significantly to making the integrated system work. (Point II)

- The Regional Act was passed to alleviate barriers to planning and constructing an adequate, efficient, economical and reliable power supply for *all* loads in the Pacific Northwest, including the DSIs. (Point III)
- The Regional Act was intended to provide permanent solutions to several problems. (Point IV) The expected benefits of the Regional Act include:
  - To regionalize power planning and operations under a "one-utility" system to reduce overall power costs to the region;
  - To allow BPA to continue to serve DSI loads so as to enhance integrated operation of the system and avoid jeopardizing a nationally important industry;
  - To assure adequate federal resources to avoid the need to allocate a power deficiency among existing and new preference customers. The region realized that preference loads would increase dramatically without the Act through the creation of new preference customers out of IOU territory and DSIs seeking service from the local utility if BPA could not serve them and normal load growth;
  - To reduce the financing cost to customers of constructing and owning generating facilities, by BPA buying the output of such facilities and reselling the output at BPA's costs; and
  - To provide wholesale rate parity for residential and small farm consumers of IOU and preference customers through the "Residential Exchange" program.
    - The Regional Act has rate directives that make the promised wholesale rate parity completely dependent on BPA's power sales to DSIs.
    - BPA has no lawful means to effectuate wholesale rate parity if it chooses not to serve the DSIs.
    - Since wholesale rate parity for the IOUs' residential and small farm consumers is contingent upon continuing power sales to the DSIs, BPA must offer power for sale to the DSIs, and the DSIs must purchase, at the statutory rate as contemplated by the Regional Act if BPA intends to continue providing Residential Exchange benefits.
- Sound business principles require that BPA have adequate notice of its expected load serving obligations. BPA should exercise its broad contracting authority to require customers to provide adequate notice of the desire for service as a means to clarify BPA's load obligations in the future. (Point V)
- Under the Regional Act, BPA should be prepared to serve the full net requirements of all Regional utilities and of all DSIs when requested to do so. In order to balance its power supply with demand, BPA must demand multi-year notice of the intent to purchase and negotiate simultaneously power sales and resource acquisition contracts.

## I. The Historic Role of DSIs

The Bonneville Project Act, 16 U.S.C. § 832 *et seq.*, which created BPA as the agency to market the output from the Grand Coulee and Bonneville projects, authorized BPA broadly to sell power for resale or direct consumption to public bodies and cooperatives (preference customers), private agencies or persons, and Federal agencies. 16 U.S.C. § 832d(a). BPA was directed to set rates to encourage “the widest possible diversified use of electric energy” and “the equitable distribution of the electric energy developed at the Bonneville Project.” 16 U.S.C. § 832e; *see also id.* § 832a(b).

President Roosevelt and his allies sought to ensure that BPA would “include extension of electric power to farms and homes, through public-power districts, as well as to big industry.” Cong. Rec. H 4432 (May 12, 1937) (Rep. Pierce). Their primary interest was economic development, and they recognized that sales to industry were important in achieving such development. *See, e.g., id.* at 4433.

BPA was also directed to give preference and priority to public bodies and cooperatives (and to encourage their formation). 16 U.S.C. § 832c. Some have argued that this provision, known as the Preference Clause, somehow nullifies BPA’s duty to serve other classes of BPA’s customers, particularly DSI customers. But preference rights are important only when the supply of power is insufficient; they do not address BPA’s underlying duties with respect to the adequacy of supply. As the Supreme Court has explained, “the preference system merely determines the priority of different customers when the Administrator receives ‘conflicting or competing’ applications for power that the Administrator is authorized to allocate administratively.”<sup>1</sup>

The Project Act also empowered BPA to build transmission lines “[i]n order to encourage the widest possible use of all electric energy that can be generated and marketed and to provide reasonable outlets therefore, and to prevent the monopolization thereof by limited groups ....” 16 U.S.C. § 832a(b). The Project Act’s provisions were designed to prevent the monopolization of Federal power for resale by IOUs.<sup>2</sup> To further assure that Federal power would not be monopolized by IOUs, the Bonneville Project Act required that BPA retain, at all times, the right to cancel power sales contracts with IOUs upon five years notice if the power were needed to serve preference customer load. 16 U.S.C. § 832d(a).<sup>3</sup>

As a result of these provisions, and the infancy of the public-power market, BPA initially focused upon sales to the electrochemical industry. Congress also knew that industrial loads, with higher utilization factors, were essential to supporting the economics of the hydro projects. As one witness testified during hearings on the Bonneville Project Act:

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<sup>1</sup> *Aluminum Co. of America v. Central Lincoln People’s Utility District*, 467 U.S. 380, 393 (1984).

<sup>2</sup> See generally “*Columbia River Power For the People, A History of the Policies of the Bonneville Power Administration*,” (“*Columbia River Power*”) pp. 69-72.

<sup>3</sup> BPA was not obligated to retain any such “recall” rights in contracts with its DSI customers.

“Electrochemical and electrometallurgical industries operate at from 50 to 90% loads, while the domestic user takes his power at only 20 to 25% of the time. You have to have those industries using great blocks of power to carry the business. And, if they carry it, then your domestic user gets the full advantage of this great use; but if you have not those big users and are only handing the power out to farmers and domestic users, there is no power plant on earth that can do that and make a success ...”<sup>4</sup>

Indeed, all of the early advocates of Federal development of the hydroelectric capabilities of the Columbia River system relied extensively on the symbiotic financial relationship between the Federal projects and private investment in large industries in the Pacific Northwest.<sup>5</sup> As BPA’s general counsel summarized in 1940:

“it was recognized by Congress that the vast amount of power produced by Bonneville Dam could not be consumed in the area in its present state of development and that marketing of the power must depend largely upon the growth of the region in population and industries.”<sup>6</sup>

From 1940 to 1945, the number of BPA industrial and utility customers increased from five to eighty, and BPA's annual revenues increased from \$376,000 to \$23,000,000. BPA's *50<sup>th</sup> Anniversary History* later concluded that the revenues from industrial sales "saved the Bonneville system from being wrecked by the private utilities. It gave the preference customers time to win their lawsuits, or their condemnation suits, or their buyouts of private utility properties after WWII. Public power, protected by the aluminum markets, was able to come in and build on top of the Bonneville system."<sup>7</sup>

Over the years, BPA was directed to market virtually all power from Federal projects in the Pacific Northwest. In addition, BPA's rate directives were modified to expressly include the goal of cost recovery. BPA was directed to dispose of Federal power "to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," which rates were to "be drawn having regard to the recovery ... of the costs of producing and transmitting such electric energy." 16 U.S.C. § 825s. But the basic marketing directives on which BPA operated were not changed until 1964 when Congress adopted regional preference.

The Regional Preference Act of 1964 established the Pacific Northwest as BPA's primary service territory and gave preference to sales "for consumption" in the Pacific Northwest over all other sales. 16 U.S.C. § 837. This Act was adopted in response to the large increase in the generating capability of the Federal hydro system made possible by four large upstream storage reservoirs constructed pursuant to the Columbia River

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<sup>4</sup> “Columbia River (Bonneville Dam) Oregon and Washington,” Hearings before the House Committee on Rivers and Harbors, 75<sup>th</sup> Cong., 1<sup>st</sup> Sess. 66 (April 22, 1937) (Statement of Governor Martin).

<sup>5</sup> *Columbia River Power* at 132.

<sup>6</sup> A. Hart, “Night Letter to Dr. Paul J. Raver,” May 24, 1940, *quoted in* G. Tollefson, *BPA & The Struggle For Power At Cost* 133 (BPA 1987).

<sup>7</sup> *Id.* at 259 (quoting BPA employee Sam Moment).

Treaty of 1961 with Canada.<sup>8</sup> Neither Canada nor the Pacific Northwest could initially utilize all of the additional power the Treaty projects made available, so actual development of the projects depended upon power sales to California across the proposed Pacific Northwest-Pacific Southwest Intertie.<sup>9</sup> However, the region was not willing to agree to inter-regional transmission facilities without legislation to protect Pacific Northwest consumers, including DSIs, from the potential consequences of diverting hydroelectric power to serve the needs of the Pacific Southwest. BPA Administrator Luce explained that:

"For years industries in the Pacific Northwest have been important customers of the Federal system. Their purchases have varied from more than 60 percent of the energy sold by Bonneville Power Administration in 1945 to an average of approximately 36 percent during the past 4 years. Their original plant investment is more than \$350 million. Their plant replacement cost would be double that figure. They employ 15,000 Pacific Northwest citizen directly and another 30,000 indirectly. *The utility of those plants and the thousands of jobs which they have made possible are directly dependent upon the maintenance of a low-cost power supply. If Pacific Northwest Federal power – and that area has no low-cost alternative – is diverted to other regions, many of these industries would have to stop production. The Nation would not gain by shutting down these plants in order to export the power from the Pacific Northwest, and the impact on that region would be catastrophic.*"<sup>10</sup>

The Regional Preference Act protected BPA's ability to make power sales to the DSIs and other Pacific Northwest consumers, but otherwise left the directives for sales within the region unchanged.

## II. Development of an Integrated Power System

By the mid-1960s, the region had developed most of the politically acceptable hydro sites in the region. Regional planners, including BPA, developed the concept of a "Hydro-Thermal Power Program" (HTPP) to meet growing power needs. The HTPP was conceived to meet two key objectives. First, the HTPP would permit development of an adequate and reliable power supply for the entire Northwest at the lowest practical cost. Second, the plan was designed to achieve optimal combination of all of the region's transmission and generating resources, both hydro and thermal, whether Federal, IOU or consumer-owned. To meet these objectives, regional utilities and the Federal government would plan, build and operate the region's entire system as if it were under a

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<sup>8</sup> *Columbia River Power* at 227-236.

<sup>9</sup> *Id* at 233.

<sup>10</sup> Congressional Record – Senate, April 23, 1964, p. S 6787 (emphasis added). This same point is made in *Senate Report No. 88-122 "Defining the Primary Marketing Area of the Bonneville Power Administration"* 88<sup>th</sup> Congress, July 25, 1963, page 7, the report that accompanied Senate Bill S-1007 which became the Regional Preference Act.

single ownership – "the one-utility concept."<sup>11</sup> Under the HTPP, high voltage transmission, peaking capacity, forced outage reserves and reserves for unplanned load growth were to be Federal responsibilities. Non-Federal utilities would build thermal generation, sized and timed for regional needs (instead of the needs of single owners) and build the low voltage transmission and distribution systems.

The transmission element of the HTPP required new legislation. The Flood Control Act of 1944 had explicitly narrowed BPA's authority to construct and own transmission facilities granted under the Bonneville Project Act. Under 16 U.S.C. § 825s, BPA was limited to construct or acquire "only such transmission lines and related facilities as may be necessary" to interconnect with customers' facilities to deliver "wholesale quantities" of Federal hydropower. Therefore, in 1974 Congress adopted the Transmission System Act, 16, U.S.C. § 838, to give BPA a very expanded role in developing transmission within the Pacific Northwest "to integrate and transmit the electrical power from existing or additional Federal or non-Federal generating units." 16 U.S.C. § 838b. In furtherance of this expanded role, the Act made BPA self-financing (*i.e.* BPA was authorized to use directly the proceeds from the sale of power and transmission services instead of sending the money to the Treasury) and authorized BPA to borrow money directly from the Treasury to spend on transmission facilities. But BPA's basic power marketing directives were not changed (16 U.S.C. § 838b), and its rate directives were expanded only to assure BPA did not discriminate between the transmission of Federal and non-Federal power and to recover the cost of any amounts borrowed from the Treasury.

In partial implementation of the HTPP, BPA entered into a number of agreements to acquire the output of thermal generation owned by preference customers through "net billing." However, the high cost of the new thermal generation, and an Internal Revenue Service ruling in 1973 that prevented the issuance of additional tax exempt net-billed bonds exhausted this avenue before the region's perceived need for additional generation could be fully met.

After net billing became unfeasible, the Region launched Phase 2 of the HTPP. During the short-lived Phase 2, the preference utilities individually and jointly were to build some of the thermal generation needed to meet the region's local growth, and the power system reserves provided by BPA's contractual rights to interrupt service to its DSI customers were expanded significantly. Role EIS at p I-19. However, the skyrocketing costs of the Phase 2 thermal plants and two court decisions requiring BPA to develop environmental impact statements under the National Environmental Policy Act of its role under the HTPP brought all progress under the HTPP to an abrupt end and created great uncertainties for the Region's electric power planning process. *Id.*

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<sup>11</sup> "The Role of the Bonneville Power Administration in the Pacific Northwest Power Supply System, Including Its Participation In a Hydro-Thermal Power Program" Final Environmental Impact Statement, December 1980 (Role EIS) at p I-16.

### III. Purposes of the Regional Act

The conditions that derailed the HTPP set the stage for the Regional Act. The Regional Act was drafted to address four principal problems that were summarized by Senator Hatfield on the floor of the Senate.<sup>12</sup> First, the region needed a viable mechanism to "pool" power from the various generating resources throughout the region to allow them to jointly operate to meet the region's total load under the "one-utility concept." S 14693. Second, Congress did not believe it was feasible for local utilities to take over serving DSI loads (both because of the size of the loads and the fact that these loads were providing reserves to the entire power system), and it was not deemed consistent with the national interest for the DSIs to cease operations for lack of a power supply. Yet, the preference clause in the Bonneville Project Act, load growth on preference utilities' systems and the creation of new preference utilities coupled with a static supply of Federal power would soon preclude BPA from serving these loads.<sup>13</sup> *Id.* S 14693. Third, BPA did not have adequate power to serve even the expected loads of existing preference customers or new ones that were forming, and Congress wished for BPA to avoid the need to allocate the resulting deficiency. *Id.* Finally, the high cost of the thermal plants developed by the region's IOUs under the HTPP had produced a huge retail rate disparity between the IOUs and publics and created political pressure for Oregon to become a public power state and aggravate the Federal power deficiency. *Id.* S 14694.

The central element of the solution to each of these problems was to be addressed by granting BPA the authority to acquire resources.

"Reduced to one sentence, the heart of the regional power bill is the authority for BPA to acquire from non-Federal entities additional electric power resources, including conservation, *to meet the electric needs of Northwest customers.*" (Senator Jackson at S 14690 (Green Book at 105) emphasis supplied).

Although BPA was authorized to acquire resources, it was not authorized to construct or own any generating facility; rather, BPA was authorized to purchase the output of facilities owned by other entities in the region.<sup>14</sup> Congress expected that by purchasing the output of customer-owned generating facilities, BPA could reduce the cost of financing such facilities by billions of dollars. (*See p. 10, below.*)

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<sup>12</sup> See Congressional Record, Senate, S 14692-5, Nov. 19, 1980 quoted in "*Legislative History of the Pacific Northwest Electric Power and Planning Act*" (BPA 1981) at pp 107-10 (the "Green Book").

<sup>13</sup> As the United States Supreme Court observed in upholding the initial DSI contracts under the Regional Act, "preference was the perceived problem, not the chosen solution" under the Act. *Aluminum Company of America v. Central Lincoln PUD*, 467 U.S. 380, 395 (1984).

<sup>14</sup> H. Rept. 96-276, Part II, 96<sup>th</sup> Congress, 2<sup>nd</sup> session 1980 at 278; (Green Book at 278).

#### **IV. The Regional Act as a Permanent Solution**

The Regional Act was plainly intended to provide a long-term solution to the problems it addresses. The overarching purpose of the Act is "to assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply" — not just in the short run, but for the indefinite future. 16 U.S.C. § 839(2). All Northwest utilities and existing DSIs were authorized to place specific loads on BPA — requirements net of resources in the case of utilities, and historic loads in the case of DSIs. 16 U.S.C. §§ 839c(b)(1) and 839c(a)(1)(A). BPA's obligation to honor requests for power from utilities was open-ended and perpetual. 16 U.S.C. § 839c(b)(1). BPA, through conservation and resource acquisition, was required to attain and maintain a sufficiency of resources to meet its contract obligation to supply power. 16 U.S.C. § 839d(a)(2).

The legislative history confirms that long-term power supply adequacy was a primary goal of Congress; the House Interior Committee report noted that the Act "expands the authority of BPA to permit it to acquire additional resources on a long-term basis to meet the needs of the region." H. Rep. No. 96-976, Pt. II, 96<sup>th</sup> Cong., 2d Sess. at 32 (1980)(Green Book at 274).<sup>15</sup> Indeed section 6 of the Regional Act made it mandatory for BPA to acquire sufficient power to serve its contractual obligations, declaring that the Administrator "shall acquire" such power. 16 U.S.C. § 839d(a)(2). There can be no doubt but that Congress expected that BPA would have "sufficient power to meet each ... customer group's load requirements." H. Rep. No. 96-976, Pt. II, at 34. As BPA Administrator Munro stated in a letter to Representatives Ullman and Foley urging passage of the Act, "[p]urchase authority is the key. ... If granted, it would instantly remove the theoretical and legal limit on the size of the federal power pool."<sup>16</sup>

##### **A. Sales to Publics**

Section 5(b) of the Regional Act required BPA to contract to sell power to preference customers to meet their load requirements to the extent such requirements exceeded the resources they owned. 16 U.S.C. § 839c(b). The purchase authority conveyed (and obligations imposed) by section 6 of the Act assured BPA of having sufficient resources to meet these requirements without the need to allocate insufficient power among such customers as would have been required without the Act. 16 U.S.C. § 839d(a)(2). In addition, section 7(b) of the Act assured preference customers that their power costs would not exceed the costs of the resources of the Federal Base System plus the additional resources acquired to meet their load growth. 16 U.S.C. § 839e(b).

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<sup>15</sup> In effect, the Regional Act gave BPA specific statutory authority to carry out the "public utility responsibility" that BPA Administrator Paul Raver had always believed BPA had undertaken as a practical matter beginning in 1937. *Columbia River Power* at 185.

<sup>16</sup> Letter, S. Munro to Reps. Ullman & Foley, April 27, 1979, *reprinted in* Hearings on Northwest Power Legislation, H.R. 3508 and H.R. 4159 before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce, 96<sup>th</sup> Cong., 1<sup>st</sup> Sess. 81-82.

## **B. Sales to IOUs**

Section 5(b) of the Regional Act also authorizes BPA to sell power directly to IOUs. However, this provision was never intended to convey to the IOUs direct access to low-cost Federal power, or to reduce the access of public agencies and DSIs that were purchasing such power when the Act was adopted and whose rates were tied by the Act directly to the costs of the Federal Base System. As BPA stated in its section-by-section analysis of the Regional Act: "[I]t is important to note that under this Act, BPA would sell no power to the IOUs not first sold by them to BPA." (Green Book at 84) Such power includes the Residential Exchange power discussed below and power purchased by BPA from the IOUs under section 6(a)(2) for sale by BPA to IOUs under 5(b) to meet the IOUs' net requirements. As Senator Hatfield explained on the Senate floor:

"The local utilities will build all future thermal generating plants, as they do now when and where they decide. Bonneville cannot purchase the output of a plant unless it can be matched against an existing contractual obligation to supply power. ... Under 5(b), (c) and (e), if any utility fails to supply BPA with enough power, BPA can restrict its obligation to that utility to the amount of power so supplied."

(Congressional Record – Senate November 19, 1980, S 14964 reported in Green Book at 109)

Theoretically, if there were surplus firm Federal Base System power not needed to meet the loads of public agencies and DSIs, BPA could sell such surplus to the IOUs, but no such surplus exists. When no surplus is available, the only intended source of power for sale to IOUs is from resources acquired from IOUs. These section 5(b) sales to IOUs are to be made at rates established under section 7(f) to recover the cost of "additional resources which, in the determination of the Administrator, are applicable to such sales." 16 U.S.C. § 839e(f). In short, BPA was to resell power to the IOUs at the price BPA paid for such power. No benefit of low cost Federal hydropower was to be conveyed to the IOUs through their section 5(b) purchases. But, as noted below in section IV.D., the purchase and sale by BPA to IOUs was expected to provide substantial financing benefits.

## **C. Sales to DSIs**

In the case of the DSIs, the "initial long term" contract was explicitly made mandatory (16 U.S.C. § 839c(d)(1)(B)). All subsequent contracts were authorized, but not expressly required, by 16 U.S.C. § 839c(d)(1)(A). However, the use of the term "initial" (*i.e.* the "first") plainly implies that Congress expected BPA to offer subsequent contracts to the DSIs. This expectation is clearly reflected in the structure of the Regional Act, its legislative history and the contemporaneous actions of BPA as discussed below. The reason that the subsequent DSI contracts were authorized but not absolutely required is that, after the initial long-term contracts (for which BPA was



"deemed" to have sufficient resources), public preference would apply in the event of an insufficiency of resources. However, BPA was fully directed to and expected to achieve the overarching purpose of the Regional Act to acquire sufficient resources to meet all loads. The risk that BPA would fail to achieve sufficiency before expiration of the initial contracts was minimal. Thus, it was contemplated that, under the Regional Act, BPA service to DSIs would continue indefinitely and, as described in section IV.E., such continued service was a necessary condition for the Residential Exchange Program to work. Indeed, in 1981, when the BPA Administrator transmitted the contracts offered to DSIs, he explained in his cover letter that:

*“This contract is the initial contract that Bonneville is required to offer each Industrial Purchaser pursuant to sections 5(d)(1)(B) and 5(g) of the Regional Act. As you know, the Act contemplates in section 5(d)(1)(B) additional, future contracts with each existing Industrial Purchaser, but unlike this initial contract, such future contracts do not have the benefit of the statutorily deemed sufficiency of power available to the Administrator under section 5(g)(7). Bonneville’s ability to offer any future contracts to its nonpreference customers, including the Industrial Purchasers, is therefore largely dependent upon Bonneville achieving load/resource balance while these initial contracts are in effect. Bonneville is aware that most, if not all, of the Industrial Purchasers are necessarily considering substantial new capital investment at their existing facilities during the period of the initial contracts, and that as a result the useful life of these facilities may be extended well beyond the 20-year term of the initial contracts.”<sup>17</sup>*

In short, while BPA has the theoretical ability to decline to offer contracts to DSIs if inadequate resources are available to serve them, the overriding intent of the Regional Act and the planning and resource acquisition efforts it was designed to engender was to avoid such a situation ever arising.

#### **D. Financing Benefits**

The Regional Act required BPA to offer power to preference customers, DSI customers and IOUs at a time that BPA believed it had insufficient power to go around. Therefore, Congress adopted a legal fiction and "deemed" BPA's resources to be sufficient to meet the contract obligations it was directed to incur. 16 U.S.C. § 839c(g)(7). Clearly, however, BPA would need real power to meet the growing real loads of its customers, and Congress anticipated that BPA would rely on customers themselves to provide BPA that power:

*"It is anticipated under this legislation that each BPA customer group will provide BPA, through the acquisition procedures of section 6, with sufficient power to meet each such customer group's load requirements. Section 5(e) of S. 885 will encourage these customer groups to actually provide BPA with such resources since it provides that customers will not*

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<sup>17</sup> Letter, P. Johnson to DSI Customers, Aug. 27, 1981, at 1-2 (emphasis added).

be restricted pursuant to section 5(b) below the amount of power that they have provided BPA pursuant to section 6."<sup>18</sup>

BPA's authority to purchase and resell power to its customers was intended to provide substantial benefits. As explained by Senator Hatfield, the purpose of these transactions was to facilitate the operation of the Pacific Northwest under a one-utility concept and to lower the cost of financing power projects:

"I expect that the money market will regard with some favor a strongly integrated industry which this bill will allow to happen, but that is not the reason this bill was brought to Congress."<sup>19</sup>

Senator Jackson, a major sponsor of the bill put significant weight on the financing benefits of BPA purchase authority:

"The advantage of the regional power bill for the Northwest will be enormous: ... Second, Regional financing of resources through BPA will result in lower resource financing costs, primarily lower interest charges and reduced equity financing costs, which will save the region billions—not millions—of dollars."<sup>20</sup>

The Regional Act expressly provided that BPA could purchase the output from generating facilities owned by DSI customers (16 U.S.C. § 839c(e)(1)(C)) to resell to such customers and therefore, that the DSI customer could benefit from the financing benefit available by such BPA purchases.

## **E. The Residential Exchange Program**

Confirmation that long-term service to DSIs was an inextricable component of the Regional Act's structure is found in the Act's section 5(c) Residential Exchange provisions. 16 U.S.C. § 839c(c). The Act expressly ties power sales to the DSIs together with the Residential Exchange program such that BPA has no ability to provide Exchange benefits without making sales to the DSIs.

The sole lawful means for BPA to address the wholesale rate disparity between residential and small farm customers of IOUs and preference customers was the Residential Exchange program. Section 5(c) of the Act establishes an exchange of power between BPA (at a price based on the rates applicable to other BPA regional customers) and the IOUs (priced at their "average system cost"). As noted in BPA's section-by-section analysis of the Act: "This [Exchange Program] is intended to provide rate relief to residential and small farm customers of IOUs." (Green Book at 86) But, the Act places many constraints on the Residential Exchange Program.

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<sup>18</sup> H. Rept. 96-976, Part II at 34; (Green Book at 276).

<sup>19</sup> (S 14694; Green Book at 109).

<sup>20</sup> (S 14691; Green Book at 106).

The most relevant constraint is found in the mandatory rate directives contained in section 7 of the Act. 16 U.S.C. § 839e. As summarized in BPA's section-by-section analysis: "Section 7(b)(2) establishes a rate ceiling for preference customers and Federal agencies which assures that their rate will not exceed what they would have been had BPA not engaged in power sales or purchase transactions with IOU. Costs that may not be recovered from preference customers [due to § 7(b)(2)] are to be covered from other customers from other rate schedules." (Green Book at 92)

Section 7(b)(2) is more complicated than is apparent from the brief summary in BPA's section-by-section analysis. As the Supreme Court has concluded, the key to supporting the Residential Exchange benefits was BPA's sale of power to the DSIs. "The Act expressly contemplates that much cost of this [residential exchange] program is to be covered by power sales to the DSIs. ... [T]he DSI sales and power exchange program were integrally related." *Alcoa v. Central Lincoln PUD*, 467 U.S. 380, 399-400 (1984). During the period from the passage of the Act through June 30, 1985, § 7(c)(1)(A) of the Act's rate directives directly allocated the cost of the Exchange to the DSI rates, to the extent such costs were not recovered from other customers. 16 U.S.C. § 839e(c)(1)(A). After July 1, 1985, two new rate directives became effective under the Act and altered the financial support for the Exchange Program. First, section 7(c)(1)(B) tied the DSI rate directly to the rates charged by BPA to public agency customers, and second, the section 7(b)(2) rate ceiling that limits BPA's authority to recover Exchange costs became effective. 16 U.S.C. §§ 839e(c)(1)(B) and 839e(b)(2).

After July 1, 1985, the section 7(b)(2) rate ceiling forbids BPA to charge the public agencies rates higher than their power costs would be under a hypothetical world in which certain effects of the Regional Act are assumed not to exist. 16 U.S.C. § 839e(b)(2). Specifically, section 7(b)(2) capped the publics' rate at a level that expressly excludes the costs of the Residential Exchange and includes instead the additional cost the publics were assumed to bear if the publics served the DSIs located in public agency territory with fully firm resources and without the power system "reserves" available to BPA through BPA's contractual rights to interrupt service to the DSIs. Under this statutory assumption, the publics would have to install additional costly generating resources to serve the DSI loads and replace the contractual reserves. In addition, the potential for cost savings under the Act of having BPA's credit standing behind the borrowings the publics would incur to install resources was assumed to be unavailable in the section 7(b)(2) world.<sup>21</sup> In effect, the rates BPA charges publics was lawfully allowed to include Residential Exchange costs only to the extent that BPA's service to the DSIs provided costs savings or revenues to offset those Exchange costs.

If and to the extent the benefits of BPA's service to the DSIs did not offset the cost of the Residential Exchange, BPA was to surcharge all rates uniformly, other than rates for sales to the publics, sufficient to recover the costs. Such other rates include the rate for the Residential Exchange (in effect, reducing Exchange benefits), the DSI rate

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<sup>21</sup> BPA does not currently believe there are any financing benefits for the publics because, unlike the DSIs and IOUs, the publics are authorized by law to issue tax-fee bonds, generally at rates lower than BPA's own borrowing rate.

and rates for direct sales to the IOUs. If no direct sales were made to IOUs, then the cost would be shared between higher DSI rates and lower Exchange benefits with most of the cost absorbed by reducing Exchange benefits.<sup>22</sup> Thus, it is clear that there can be no Exchange benefit under the Regional Act unless BPA offers to serve the DSI loads.

The language and legislative history of the Regional Act, contemporaneous construction of that Act by BPA and others, and the fundamental purposes of the Act all compel the conclusion that Congress intended BPA to provide continuing service to the DSIs as part of its overarching mission to provide an adequate power supply for the Region. Indeed, under the Act's design, the important statutory purpose of reducing disparities between the residential and small farm rates of publics and IOUs can only be achieved through such continued service to DSIs. BPA has no authority to simply transfer money to IOUs or to sell them power earmarked for residential consumers except through the statutory Residential Exchange program.

## **V. Clarifying BPA's Load Obligations for the Future**

While the Regional Act expressly obligated BPA to offer contracts to regional utilities and plainly contemplates that BPA would offer contracts to DSIs indefinitely as well, the precise terms of such contracts were left largely to negotiations between BPA and customers and to the discretion of BPA. In 2001, BPA chose to allow customers to wait to decide whether to put loads on BPA until after BPA had established rates, and only shortly before deliveries under the contracts were to begin. As a result, BPA substantially underestimated its load obligations, set rates that were inadequate, and was caught short of resources in what turned out to be an extraordinarily high-priced market. BPA and all of its customers were seriously harmed by these events.

BPA needs to insist that it have adequate notice of the loads its customers will place on it to allow it to arrange for resources or other power supplies in a considered and business-like fashion. On the other hand, BPA cannot expect essentially firm commitments from customers to purchase power unless it provides customers reasonably firm prices. This essentially requires that BPA solicit notice of intent to purchase and proposals to sell well in advance (preferably 3-5 years) of the commencement of deliveries, and negotiate the purchase and sales agreements simultaneously to arrive at load/resource balance at known rates. These known rates should be available only for load identified by customers during the notice period.

This is not to suggest that BPA should refuse to serve customers' loads if the customer fails to provide timely notice of its intent to place loads on BPA. There is no need for BPA to do so. BPA has broad authority on how to design its rates within the cost recovery directives. 16 U.S.C. § 839e(e). Moreover, all of BPA's customer specific rate directives authorize BPA to establish "rate or rates" for each customer class. In the case of section 5(b) sales to the IOUs, BPA has the flexibility to set a separate rate for each and every sale to an IOU under 16 U.S.C. § 839e(f). For publics, section 7(b)

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<sup>22</sup> Residential loads will substantially exceed DSI loads on BPA, so any surcharge would serve to reduce Exchange benefits substantially.

applies only to rates of "general application" (16 U.S.C. § 839e(b)(1)) and need not be read to preclude BPA from setting special rates for power requests made after a notice period. Similarly, for any DSI that fails to provide the requested notice, the section 7(c)(2) "applicable wholesale rate" would be the same as for a public agency customer that failed to provide notice, presumably the cost of the specific resources acquired to meet the load.

Thus BPA can allocate its base costs to loads from each customer class for which it has timely notice. It can create a second tier rate for each customer class to cover the incremental costs of incremental loads in excess of the amount for which BPA receives timely notice. In short, BPA can solve the entire issue of defining its post-2006 service obligation by requiring from each customer advance notice of intent to purchase coupled with a second tier rate applicable to customer's loads that exceed the noticed amount.

### **Conclusion**

Under the Regional Act, BPA should be prepared to serve the full net requirements of all regional utilities and of the DSIs at statutory rates when provided reasonable notice. In order to balance power supply and demand, BPA should require from each customer multi-year notice of the intent to purchase and then negotiate simultaneously power sales and resource acquisition contracts. Loads for which timely notice is not provided should be subject to special rates designed to recover the full cost of meeting those incremental loads with incremental resources. In addition, BPA should stand ready to purchase the output of an appropriate customer-owned resource to provide the financing benefits contemplated under the Regional Act, and sell power to such customer as intended under the Regional Act.