DSI-083
MAR 14 2005

Kuehn,Ginny - DM

From: Wilcox, Brett [Brett@nwaluminum.com]

Sent: Friday, March 11, 2005 3:10 PM

To: Wright,Stephen J - A; Norman,Paul E - P; Oliver,Stephen R - PT; Wilson,Scott K - PS; Clark,Harry W - PTS; BPA Public Involvement

Cc: Gerry Miller (E-mail); Paul Murphy (E-mail); Eric Redman (E-mail)

Subject: Additional comments on DSI Service 2007-11

Attached are additional comments following up on the March 1 Open Forum on DSI Service

<<001 Cmts BPA's Post 2006 DSI Service 2-28-05 (LH).doc>>

0 5 I - 083
MAR 14 2005

March 11, 2005

Steve Wright
Administrator and CEO
Bonneville Power Administration
Mail Route - A
P.O. Box 3621
Portland, OR 97208

RE: Follow-up to March 1 Open Forum on DSI Service 2007-11

Dear Steve:

I want to thank you for convening, and personally devoting all day to, the Open Forum on BPA service to the Direct Service Industries during the 2007-11 period. The purpose of this letter is to follow up on your closing comments and to attempt to bring greater consensus to these crucial issues.

Amount of Power and DSI Minimum Requirements

I believe you correctly summarized that the DSIs should not be treated as a disposable marginal load. There seems to be broad acceptance that the amount should be "more than zero" but not so great as to have a really significant rate impact on other customers.

You expressed concern that the aluminum industry had submitted three different proposals and that two companies were asking for too much. Alcoa wants 438 MW just for its own needs at Intalco. Glencore asked BPA to serve half the load at CFAC and half at Evergreen. Applying either of these company's proposals to the entire industry results in about 850 MW of total service.

While I agree with the other aluminum companies that 850 MW of BPA service could easily be justified, I'm willing to concede that such an amount would have an unacceptable rate impact from the point of view of other customers. For that reason, GNA proposed that BPA limit future DSI service to 500 MW of power or equivalent financial benefits. But rather than arbitrarily allocating power between the companies, we proposed that BPA should provide power or benefits to smelters that actually create jobs in proportion to each company's actual operations. Alternatively, GNA and the United Steelworkers Union proposed 100 MW per smelter, so that each plant could maintain "pilot light" operations of one cell line and be in a position to leverage this BPA base supply to higher operations and more jobs when conditions allow.

1016/007/a/001

Alcoa responded that because of economies of scale, they need a BPA supply for Intalco's full requirements. The short answer to Alcoa's argument is that Intalco currently is operating at about 40% of capacity or 177 MW. This level of operations must be viable as a "pilot light," or they wouldn't be doing it now. Alcoa Wenatchee also is operating a part of the smelter with a base supply of low cost power from its interests in Rocky Reach.

Similarly, CFAC currently is operating one of five cell lines with about 70 MW. CFAC said they need to operate a minimum of two to three lines. Since the CFAC's cell lines are small compared to other smelters, two lines or about 140 MW may be a reasonable minimum.

GNA needs a minimum of 200 MW, or about 109 MW for one of three lines at Goldendale and 85 MW for one of two lines at The Dalles, plus a small amount of non-process load. This amount of power would allow us to maintain "pilot light" operations at each smelter and put us a position to increase production and leverage the BPA commitment when market conditions allow.

If BPA provides 177 MW to Alcoa Intalco, 140 MW to Columbia Falls, 109 MW to Goldendale and 85 MW to The Dalles, it can meet the demonstrated or stated minimum operating requirements for each smelter. This results in 511 MW of total power or financial benefits, which is consistent with BPA's target range.

John Saven's Proposal

As I understand it, John proposed allocating up to 300 MW of power to companies in proportion to their current operations and 200 MW of additional financial benefits in proportion to actual operations during the 2007-11 period.

By first allocating a block of power to some companies only, and then remaining power or benefits to all companies (including those in the initial allocation), this proposal effectively "freezes out" GNA's smelters from meaningful participation. It also has the effect of counting currently operating loads twice—once in making the initial allocation and a second time when allocating residual power or benefits.

Rather than allocating in a two-tier process that double counts some loads and excludes others, BPA could provide a "guaranteed minimum" to loads currently operating. GNA proposed that, rather than allocating in advance, BPA provide power or benefits in proportion to actual operations, much like the second-tier in John's proposal. GNA would modify this proposal to ensure that Alcoa Intalco would get a minimum of 177 MW and Columbia Falls 70 MW of power or financial benefits. This protects currently operating loads as does John's first-tier, without creating the problems inherent in a two-tier allocation.

The Non-Aluminum DSI

Port Townsend Paper is in a unique position as the only remaining non-aluminum DSI. Their power requirements are relatively small (about 16 MW) and, but for special historical circumstances, they would have been served by their local utility, just like other companies in their industry. GNA would support treating Port Townsend differently than aluminum DSIs. BPA simply should negotiate a surplus sale of an amount of power up to their requirements at a rate that reflects PF costs plus the premium Port Townsend offered and would pay as a normal utility customer.

Making a Deal Stick

You stated in your closing remarks that the potential problem of GNA's proposal is making a deal for 500 MW stick. GNA's proposal should be acceptable because it meets every company's reasonable minimum needs, even if it doesn't meet some companies' full desires. Some DSIs may not be satisfied with any realistic proposal. As a practical matter BPA cannot fully satisfy all DSIs. But BPA does need some DSI support, or the proposal has no chance of working as intended.

While other companies may not be willing to support anything less than their full demands, GNA will actively support a decision that provides 500 MW of power or equivalent benefits on a non-discriminatory basis. BPA's decision simply needs to give each remaining smelter a chance to succeed, rather than guaranteeing economic benefits to one or two companies. BPA cannot arbitrarily pick winners and losers among the companies, communities and employees.

BPA can ensure that a reasonable deal for 500 MW sticks by putting a condition in its proposal that, in order to get the power or benefits BPA offers, the company must agree that the it will not advocate for an additional BPA supply. GNA recognizes that, as a practical matter, no company has a right to BPA power. Instead the limited amount of power BPA makes available should go to the smelters that actually provide jobs in rural and distressed communities.

Thank you for the opportunity to make these additional comments.

Sincerely,

Brett Wilcox
President and CEO

INDUSTRIAL
CUSTOMERS OF
NORTHWEST
UTILITIES

KEN CANON
EXECUTIVE DIRECTOR

DSI-084
MAR 14 2005

March 10, 2005

Mr. Paul Norman
Bonneville Power Administration
P.O. Box 14428
Portland, OR 97193-4428

RE: ICNU Comments on DSI Service

Dear Paul:

The Industrial Customers of Northwest Utilities (ICNU) is a regional, industrial trade association representing industries in the pulp and paper, wood products, metals, chemical, aerospace, food processing, petroleum, and the technologies industries. A membership list is attached. All are sensitive to costs, including the cost of electricity. All of these companies produce commodity products and are engaged in fiercely competitive global markets. Many of these companies purchase electric power from public agencies that are customers of Bonneville Power Administration (BPA).

ICNU member companies provide high quality jobs in the region, often in rural communities. Many of these companies have facilities that predate the formation of BPA. Some were offered the opportunity to be a DSI, but declined, choosing instead to purchase from the local publicly owned utility in order to support the local community. As a consequence, ICNU members pay a local margin to the publicly owned utility and also pay state and local energy taxes through their publicly owned utility.

Through a predecessor association that merged into ICNU (the Association of Public Agency Customers (APAC)), ICNU members have engaged on a number of DSI issues. These include the "fire sales" of the early 1980s, the DSI variable rate and Con Mod in the late 1980s, and the controversial 1995/6 DSI contracts. We did so out of a concern that the rates and service offered to the DSI directly affected the electric power rates paid by ICNU members.

In order to make an informed and considered decision on continued DSI service, ICNU members have met with the DSIs and have carefully reviewed the proposals from the various DSIs. We have also engaged in continuing discussions with BPA and the publicly owned utilities regarding this issue.

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PORTLAND, OREGON 97232-2185

While recognizing that BPA has made a decision to provide some level of service to the DSIs in a previous Record of Decision, ICNU members want to be on record opposing any sales to the DSIs that would increase BPA's rates to the publicly owned utilities.

We do not find the DSIs' arguments regarding jobs, their historic role, or fairness to be compelling. ICNU members' jobs are just as important to their employees and communities as are the DSI jobs. The level of BPA rates can have a direct impact on these jobs and communities. In addition, there are more jobs at risk in non-DSI industries. As mentioned before, all industries (even IOU industries prior to 1973) played a significant historic role in assisting the development of the region's hydro system. As to the "fairness" issue, we do not think it appropriate to simply overlook the fact that the DSIs are different than those industries purchasing power from public power utilities. The publics providing power to industrial customers have a statutory right to preference power. The DSIs don't. In the past, the DSIs have used that difference to their advantage. Now that that difference may not work to their advantage, they want to ignore it away.

However, the result is the same. Public agency customers (residential, commercial and industrial) are being asked to subsidize power sales to the DSIs. ICNU members oppose such an approach, as it provides no benefit to public agency customers and shifts costs to ICNU members that face their own competitive challenges.

It is interesting to note that one method being discussed to provide power to the DSIs involves BPA making a surplus sale to a public owned utility that could then make a wholesale sale to a DSI. This could avoid the New Large Single Load (NLSL) issue (since it is a wholesale sale) or a sale at the IP rate (where the industrial margin would come into play). The very nature of such a proposal demonstrates the nature of the differences between the DSIs and other industries. No other industry enjoys the unique benefits of being a DSI (i.e. the IR transmission contracts, the potential avoidance of NLSL, and the avoidance of local taxes and utility margins) while also seeking the statutory benefits of public agency industrial customers. It is very unlikely that such a sale would ever be made to another new industry of a public power utility that needs a lower rate to operate. If the cost of any DSI subsidy causes the potential demise of a public agency industrial customer, will BPA create another subsidy for that distressed company?

If the Administrator decides that it is appropriate for other customers to subsidize the DSIs, then important protections must be hard-wired into any such proposal. These include the following:

1. Annual dollar limits on the amount of the subsidy, with a minimal (less than 0.5 mill/kWh) impact on the PF rate. Any subsidy should be known and capped. It cannot be open ended or subject to manipulation.

2. The DSIs should receive benefits only to the extent that they actually operate.

3. The DSIs should not have remarketing rights.

4. The subsidy should only be for the next three year rate period.

5. Any subsidy should be through a power sale.

6. There should be a clear recognition that there is no obligation for public power customers to provide power rate subsidies to ensure the operating survival of the DSIs under any set of circumstances.

7. Any DSI contract should be take or pay.

8. Any eligible DSI should be credit worthy.

9. To be eligible, any DSI must have been operating continuously.

Thank you for the opportunity to comment.

Sincerely,

Ken Canon

Ken Canon

INDUSTRIAL
CUSTOMERS OF
NORTHWEST
UTILITIES

KEN CANON
EXECUTIVE DIRECTOR

DSI-084
MAR 14 2005

MEMBERS OF INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

Air Liquide
Air Products
BPB Gypsum, Inc.
Blue Heron Paper Company
Boeing
Boise Cascade
CNC Containers, Northwest
Chemi-Con Materials Corporation
Dyno Nobel, Inc.
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Grays Harbor Paper, L.P.
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Longview Fibre
Microsoft Corporation
Norpac Foods
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Shell Oil Products US
Simpson Paper
Simpson Timber
Solar Grade Silicon LLC
Tesoro Refining and Marketing Co.
Wah Chang
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3/14/05

GLENCORE Ltd.

DSI -085
MAR 14 200_

March 11, 2005

Stephen J. Wright
Administrator
Bonneville Power Administration
P.O. Box 144428
Portland, OR 97292-4428

DSI SERVICE POST 2006

Dear Mr. Wright:

The decision before Bonneville concerning the service to DSI companies beginning in 2006 is of great importance to Glencore. As the owner of two of the six remaining aluminum smelters in the Northwest, Columbia Falls Aluminum Company LLC and Evergreen Aluminum LLC, we are well aware of the value of cost-based power from Bonneville.

Momentum seems to be pushing in the direction of financial benefits rather than physical power contracts for the DSIs. We would like to bring to your attention the potential impact that this mechanism will have on the DSIs. Given the forward market in power in the Northwest, we foresee with strong likelihood that we will be given no other choice but to shut down Columbia Falls, our aluminum smelter in Montana, when the current power contract ends in September 2006. We believe that a financial deal for the DSIs as proposed by Bonneville will fail to maintain jobs in the Northwest.

To be clear, our preference is to secure a physical contract with Bonneville. However, we understand that Bonneville is in a difficult situation that does not lend for pleasing everyone. Given the circumstances, we believe a compromise may be found in approaches outlined by several public utility representatives in their formal comments to Bonneville last fall and most recently during the March 1 panel discussions – some mix between cost-based power and financial benefits. If cost-based power is a significant enough portion of a combination package we believe that it could be successful in maintaining aluminum production and jobs in the Northwest.

We recognize that Bonneville is also faced with a difficult task of allocation among the DSIs. We propose that Bonneville allows for reallocation among the DSIs in the next contract. We believe that any one of the six smelters should be given the opportunity to utilize power or financial benefits unused by other DSIs in an effort to maintain or create jobs in their respective communities.

We know that this has been a difficult issue for you and the agency and sincerely appreciate the hard work being put forward. Your personal commitment to finding an equitable solution to the DSI service issue is much appreciated. It is our hope that the issue of DSI service can be determined soon so that we can continue to shape our business plans with the knowledge that we have a significant piece of cost-based power on which to build. Thank you for your consideration.

Sincerely,

Matthew Lucke

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WASHINGTON STATE LEGISLATURE

DSI-086
MAR 14 2005

March 11, 2005

Stephen Wright
Bonneville Power Administration
905 NE 11th Avenue
P.O. Box 3621
Portland, OR 97232

Re: PT-5

Dear Mr. Wright,

We are writing to express our sympathy for the difficult choices that you have to make regarding future benefits to the Direct Service Industries currently served by the Bonneville Power Administration. We understand the statutory obligation of BPA to provide service to the DSI has expired, and we would like to thank you for still shopping an offer of benefits at the level of the "straw proposal" contained in Paul Norman's letter of February 4, 2005 to the region. Many of the DSIs have long been good corporate citizens of the region, particularly those that are still operating and providing good family wage jobs, such as Alcoa and Port Townsend Paper.

As you know many factors contribute to the success or failure of the aluminum smelter DSIs, and several in the region have not been able to maintain a sustainable business plan, while others have managed to continue to operate. The cost of electricity is certainly one factor in the survivability of the aluminum smelters as is the cost of alumina and the world market price of finished aluminum. While the region supports and can assist with providing some benefits in the form of below market electricity prices, we obviously cannot assist in controlling the risk associated with the costs of alumina and aluminum that together contribute to the survivability of the region's aluminum smelters.

Attempting to offset the commodity price risks with corresponding reductions in the price of electricity beyond a known and capped benefit could lead to unchecked costs to the region. If all of requests for all DSI benefits were awarded, the costs to the region would exceed $150,000,000, which would be paid directly by the other customers of Bonneville. And, if the administration's current efforts to raise BPA's electricity costs to market pricing prevail, the costs to the region of keeping smelter electricity prices artificially low could skyrocket to perhaps double that amount.

Stephen Wright
Bonneville Power Administration
March 11, 2005
Page 2

We believe that your straw proposal of approximately 500 aMW as a known benefit with a $40 million cap, distributed among the DSIs that have continued to operate, are creditworthy and provide and maintain jobs in the region, is a fair offer in this uncertain economic time for the region. Keeping the benefits known and capped will reduce the risks to your other customers in the region that are underwriting these benefits. Your customers and their ratepayers are in the midst of paying the highest prices for electricity that the region has ever seen and those ratepayers, including other industrial and commercial customers need certainty in their own business costs as well.

We appreciate your consideration of our request in your deliberations.

Sincerely,

Erik Poulsen

Senator Erik Poulsen
Chair
Senate Water, Energy
And Environment Committee

Lisa Brown

Senator Lisa Brown
Senate Majority Leader

DSI-087

MAR 1 4 2005

March 11, 2005

Paul Norman
Senior Vice President, Power Business Line
Bonneville Power Administration
PO Box 3621
Portland OR 97208-3621

RE: Clatskanie People's Utility District Comments Regarding DSI Service

Dear Mr. Norman,

Clatskanie People's Utility District ("District") is grateful for the opportunity to submit the following additional comments regarding Direct Service Industry ("DSI") service by the Bonneville Power Administration ("BPA") after September of 2006.

The brief principles provided below are offered in the spirit of the historical service to the DSI loads and are reflective of the evolving electric power industry, wholesale power markets and burgeoning utility self-reliance the District believes must characterize the future of the utility industry in the Northwest.

> BPA shall provide service to the DSI's at the same price and under the same credit requirements as the preference customers. DSI's shall not be allowed to resell any power provided through this service.
>
> BPA shall nat acquire any new resources beyond the existing inventory to serve the DSI's.
>
> BPA shall sell only power available from its secondary or firm surplus. Any shortfalls shall be met either through power self-supplied by the DSI's or through DSI load curtailment.

The District feels these brief principles should serve as the benchmark for any DSI service. They are reflective of the District's successful use of secondary power used to serve industrial loads which is designed to reduce market price risk across customer groups and provide predictable secondary revenue.

Thank you for the opportunity to comment. Should you have questions or need clarification feel free to contact me.

Greg Booth
General Manager

PNGC Power
Smart. Local. Connected.

March 11, 2005

DSI-088
MAR 14 2005

Mr. Paul Norman
Bonneville Power Administration
P.O. Box 14428
Portland, OR 97293-4428

RE: PT-5 Comments on BPA Service to Direct Service Industries (DSIs)

Thank you for this opportunity to make additional comments on proposals to provide DSI benefits in fiscal years 2007-2011. PNGC Power and its fifteen member/owner utilities remain very concerned about the costs impacting BPA as it enters this next rate period. It is from this perspective that we make the following observations about benefits for the DSIs.

We understand that the Administrator has made the decision to provide some level of benefits from the federal power system to DSIs. In light of that decision, we will provide some constructive comments regarding proposals by BPA and others to provide DSI benefits.

However, before discussing current proposals, it is useful to remember that PNGC Power and others remain engaged in litigation regarding the question of service and rates to DSIs. As stated in our earlier Regional Dialogue comments, our position is that BPA is not obligated to provide power to a DSI and lacks legal authority to subsidize rates for DSI service or development of generation by current or former DSIs or affiliates, let alone serve them under terms and conditions that would ensure DSI operation. Similarly, it has been our position that if continued DSI operation is considered necessary public policy then any resulting subsidies should be borne by U.S. taxpayers, not Northwest ratepayers.

Even as we continue to pursue that lawsuit, we recognize that customers have the option of waiving their right not to bear the additional costs of serving DSI customers, and that current and future lawsuits have at least the potential for settlement.

We are also mindful of the fact that the DSIs and their representatives are often helpful allies on various issues facing the Northwest and BPA's customers. And, PNGC Power respects the need to maintain a manufacturing base in the region and recognizes the impacts these plants have on local economies.

Our comments are divided into three parts: the impact of the proposals, the need for a comprehensive resolution of issues, and specific requirements for any DSI service.

Impacts to Customers

Acquiring high-cost resources to serve DSI loads and shifting a substantial portion of those costs to customers with statutory preference and priority rights has a significant impact on the

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customers of consumer-owned utilities. The reduced amount of the proposed cost for this next rate period, as opposed to the last set of contracts, would be some improvement. Nevertheless, BPA's proposal of $40 million in benefits would mean $2.6 million to PNGC Power every year. That is real money to our members which will have a rate impact on customers, particularly in marginal years where other factors such as low water levels put additional pressure on rates. The subsidy of the $40 million BPA proposal for the DSIs is $42,553 per job (assuming the current level of 940), or $17,167 per job at the full level of 2300 jobs existing at the currently viable aluminum plants. Without a subsidy to the DSIs, those dollars flow through to many more jobs and add value to a broad array of businesses and communities.

But, beyond the question of whether BPA's preference customers can absorb a $40 million expense, the larger question is whether they can absorb that cost on top the myriad other costs we face in this rate case. The estimated $691 million for fish and wildlife, large increases in expenses for the Army Corps and Bureau of Reclamation, increases in costs for Columbia Generating Station, increases in other administrative overhead at BPA, and costs associated with the residential exchange are only some examples.

In light of these costs, can we achieve a meaningful reduction in BPA's base rate? Within the current Power Function Review discussion, BPA's estimated total costs currently yield about a 28 mill rate, plus risk mitigation that could put the rate likely in the 30-32 mill range total. Obviously, that is not a meaningful reduction from the status quo. DSI benefits become even less attractive if it looks like BPA is not going to hit reasonable rate targets.

Comprehensive Approach

Several things must come together to make any proposal for DSI service more palatable.

Costs: In light of the discussion above, the first element is one of cost and rate control. BPA should not commit to any specific subsidy for the DSIs for more than one rate period. A workable DSI proposal for the next rate period would have BPA showing that it can get to the target outlined by the customers of 27 mills for power in this rate case. At higher rates, the proposal look too harmful to other customers; and, the DSIs themselves may not be able to use the power since higher rates will push them into having an uncompetitive product on the world market.

Regardless, under no circumstances should power be offered at rates below preference customers. And, under no circumstances should the impact to BPA's other customers go above $40 million annually which is substantially above the $26 million fixed subsidy that BPA first mentioned in discussion of this topic.

One way that the DSIs could help in this area is by showing that they can help provide benefits to BPA's rates of more than the $40 million subsidy proposed through strong advocacy in the areas driving BPA's costs up.

Long Term Issues/Allocation: a related piece of the puzzle that would help make a DSI resolution in the short term more tolerable would be having some agreements in place on the long-term regional dialogue. This would include approval of a long-term allocation of power that tracks closely to the proposal offered by public power, meaningful cost control provisions, meaningful mechanism for cost separation, and long-term contracts that are durable and enforceable. Pinning down these key elements that are needed to clarify future costs of preference customers is a precondition for any settlement of DSI litigation and support for any level of financial assistance for the DSIs.

We recognize that BPA is only trying to set the 2007-2011 policy with respect to DSI service at this time. However, we know that agreement on this host of long-term issues must happen sooner rather than later if we are to receive any clarification of our resource options prior to the next contract cliff. BPA should make offers to the DSIs contingent on achieving a supportable agreement with the Joint Customers on the specifics of a long-term deal.

Strawman Proposals and General Conditions for DSI Benefits

The BPA strawman proposal contains several concepts that would be beneficial to any proposal to provide DSI service. We appreciate the inclusion of language stating that BPA would take no credit risk, that costs would be known and capped, that benefits only occur in relation to real operations and employment, and that creditworthiness, past performance, and future business plans are all critical criteria. We will discuss a few areas below.

Form of Benefit: While we appreciate the intent and rationale behind BPA's monetization approach, we have concerns at this point about the legal mechanics of providing dollar pay-offs to an industry, especially over any long period of time. Similarly, we are worried that there is no durable rationale for establishing the dollar limitations, and that these dollar levels would be the subject of political efforts to change.

By contrast, megawatts may have more simplicity and logic. They can be related to specific operations at specific plants, and they provide closer alignment with other customers. This might have the effect of tying us closer together politically. However, the value of this power benefit would need to have a capping mechanism as well as discussed in "cost caps" below.

With regard to providing benefits through indirect service of some kind, we fear there is likely no way to put DSI service on a comparable basis as other industrials this late in the game. In addition, we are concerned about the incremental risk to individual utilities as opposed to regionalizing risk or costs.

Credit Worthiness: We agree with BPA in putting this at the forefront of criteria for service. There need to be adequate conditions to screen out companies from a credit standpoint and from a past performance standpoint. Whether companies have honored past obligations to the agency is a key concern as we have seen the charges for written-off DSI bad debt passed on to us through Slice true-ups. Seeing the impact of that charge directly makes this a difficult concern to set aside moving forward.

Rates: Put simply, DSIs should not pay less than other customers and the terms and conditions should be no better than those offered to other customers. Ability of a plant to operate should not impact this concept. With the current rate pressure on the region's other business and residential end use customers, BPA can not be put into a position of ensuring the operation of these plants in one industry.

Cost Caps: The costs should be certain and capped. We would not support 500 aMW of service if the delta between market and PF drives the cost of that above the $40 million ceiling. Therefore, in offering power only, the cap of $40 million (or less) should drive the size of the power offering, and BPA should arrange to lock down the cost. The DSI contract duration ought to be a fairly short in duration such as the 3 year term of the next rate period. It is important to know the overall cost at contract inception, so matching the contract duration with the augmentation purchase term may be a way to achieve that goal.

Jobs: Benefits should only flow to those DSIs that actually operate. While this issue is about jobs, it is not about insulating a certain industry from market forces. We would be open to the idea of arrangement for a put option in the case that a plant temporarily shuts down if the DSI pays for the market risk. However, there should be no resale provisions in the traditional sense.

Conclusion

While we are on record in disagreement with the initial decision to offer federal power benefits to the DSIs, PNGC Power appreciates the challenge of the BPA staff in trying to create workable solutions and in taking comprehensive regional comments on those through the all-day forum and in writing. In the end, DSI service in 2007-2011 represents legal risk to the agency unless lawsuits are settled. While we would oppose an offering of DSI service absent some corresponding value to preference customers, we see potential avenues toward agreements in resolution of the long-term issues, in reduction of overall rates, and in continuing control of the total costs and in clearer segregation of the costs that impact our rates. Progress and commitment on these issues provides a potential path toward legal and political sufficiency of any resolution.

DSI-089
MAR 1 4 2005

Kuehn,Ginny - DM

From: Detbkmom@aol.com
Sent: Sunday, March 13, 2005 7:20 AM
To: BPA Public Involvement
Subject: Alcoa Power Supply

To Whom It May Concern:

I have many friends and family who rely on their job at Alcoa. If Alcoa's power rates are increased, my family members will lose their jobs. Anything that can be done to supply Alcoa with affordable power would be greatly appreciated by not just them, but by the whole community!

Thank You,

Tamara Dether

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DSI-090
MAR 14 2005

March 11, 2005

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

Re: Comments on Post-2006 Service to DSI Customers

Dear Paul,

Attached you will please find the comments of the Western Public Agencies Group on the topic of service by BPA to the direct service industrial customers in the post-2006 period. The utilities that comprise the Western Public Agencies Group appreciate the opportunity to comment on this topic.

Should you or your staff have any questions regarding these comments, please feel free to call me.

Yours truly,

Terence L. Mundorf
Attorney for the Western
Public Agencies Group

3/11/04

COMMENTS OF THE WESTERN PUBLIC AGENCIES GROUP REGARDING POST-2006 DSI SERVICE

1. Introduction

The utilities that comprise the Western Public Agencies Group ("WPAG") appreciate the extended opportunity to comment on the topic of BPA service to the direct service industrial ("DSI") customers in the post-2006 period. Given the current high level of BPA's rates to its preference customers, and the pressing need to substantially lower those rates at the earliest possible time, it is appropriate that BPA seek the advice of its preference customers on the topic of providing a power cost subsidy to the DSIs.

The following comments are presented in three parts. The first part deals with the propriety of continuing the power cost subsidy to the DSIs. The second part offers comments on the BPA straw proposal. And the third part offers an alternative approach for structuring this subsidy.

2. BPA Should Reconsider Continuing the DSI Power Cost Subsidy

In the recent Record of Decision, BPA made a decision to provide some "benefits" to the DSIs for the post-2006 period. The nature, magnitude and delivery mechanism for these benefits was left for further regional discussion. There are good and substantial reasons why this initial decision should be reconsidered.

Currently, BPA's rates to its preference customers are at historically high levels. Further, preliminary information made available in the Power Function Review ("PFR") process indicates that in BPA's opinion, there are many costs looming on the horizon that may make it difficult or impossible to substantially reduce its rates, even without the costs of a subsidy to the DSIs. It is premature to even discuss the prospect of adding costs to BPA's preference customer rate in order to subsidize the DSIs when BPA has yet to assure its preference customers that the target rate of 27 mill per kilowatt-hours suggested by the Joint Customers will be achieved.

It is also a politically inopportune time to be having a regional discussion on the size of a power cost subsidy to a subset of BPA customers. The President's budget proposal to take BPA to market level rates is based, in no small part, on the accusation that BPA power rates are subsidized. The response that the region does not benefit from a subsidy, and could ill-afford a move to market rates, is severely undercut by this regional discussion of how big a power cost subsidy BPA should provide to the DSIs.

And lastly, the notion that BPA can place, let alone enforce, a meaningful limit on the size or costs of a DSI subsidy does not comport with recent experience. The last offer of service to the DSIs during the Subscription process started at 500 aMW, and due to political intervention ended up at about 1500 aMW. And the mere mention of a power cost subsidy has already resulted in smelters that have been inoperative for years, and some of which defaulted on their BPA payment obligation, suddenly coming to life and demanding more power at a lower price. Recent history indicates that this dynamic is largely outside the control of BPA, and will drive both the size and the cost of this subsidy to levels not currently being discussed. And the consequences of this proposal, wherever it ends up, will be borne by BPA's preference customers.

For these reasons, BPA should reconsider its decision to offer "benefits" to the DSIs, and let the current contracts terminate without replacement.

3. The BPA Straw Proposal Has Material Flaws

The BPA straw proposal, as presented at the March 1 forum, would rely on a "surplus" power sale to the public utility that hosts a smelter. This surplus sale would then be monetized, or converted into a fund of money that would be provided to a DSI to offset the market price of power when the DSI operates. Apparently, there would be no delivery of federal power, only money. And the money would only be provided if the DSI meets certain conditions that have yet to be established. BPA says that it would cap this transaction at 500 aMW and $40 million for the entire DSI class, and would only allow participation by DSIs whose business plan BPA has analyzed.

This proposal suffers from a number of operational, financial and legal shortcomings, which are described below.

Surplus Sale – The idea to base this transaction on a surplus sale runs into the reality that BPA has no surplus to sell. If BPA intends to make an augmentation purchase to procure actual power to sell, this will add costs to the transaction that are not currently accounted for that will put additional, untimely upward pressure on BPA's preference customer rate.

On the other hand, if BPA is not intending to have actual surplus to base this transaction on, then the surplus sale is a sham transaction that is being proposed merely as a pretext to enter into a financial transaction under which BPA would delivery money to the utility rather than power. Conducting business in this manner is a legally dubious proposition, since it is using a sham transaction as a cover for a financial deal that is not authorized under existing law. This approach will undoubtedly lead to further divisive litigation, especially if the limits BPA currently proposes for this subsidy do not hold.

Utility Sale – Using the host utility as the delivery vehicle for this DSI subsidy also presents problems. Literally for decades, BPA has enforced on preference and industrial customers the New Large Single Load ("NLSL") policy to limit access to low cost federal power by industrial concerns. The straw proposal apparently would ignore the NLSL and allow DSIs, that should be treated as NLSLs under current BPA policy and statutes, to access low cost federal power through their host utility.

This approach flies in the face of long-standing BPA policy on NLSLs, and ignores the requirements of the Pacific Northwest Electric Power Planning and Conservation Act in this area. This will likely have a number of detrimental impacts. First, it will prompt other non-DSI industrial concerns to seek the same favorable power supply and rate treatment. If they are granted such treatment, it will add yet more costs on the preference customer rate. If they are denied such treatment, it will provoke additional litigation.

Basing the DSI subsidy on a delivery mechanism that is at odds with BPA's long-standing NLSL policy is a poor public policy.

Finally, this proposal seems to spread the credit risk, rather than reduce it. By using the host utility as the conduit for the monetary payments, the credit risk and risk of default will be borne, at least in part, by the local utility and its other customers. And while some host utilities and their customers may wish to assume this risk, those that do not wish to do so will have no realistic alternative if this is the only manner in which BPA elects to deliver "benefits" to the DSIs. Hence, the risk of this transaction will be spread directly to host utilities, and their customers, who have no desire to shoulder this burden.

The fact that host utilities, willing or otherwise, will bear some of the risk of this transaction does not mean that BPA will be relieved of such risk. At the end of the day, given the relative size of the serving utilities and the prospective DSI load, these utilities will be financially incapable of absorbing a default in payment. As a consequence, BPA will remain the financial backstop for these transactions.

The last consideration in this area is the impact of providing service through the host utility on the current discussions of allocating the federal power system. There is nothing in the straw proposal that establishes as a matter of policy that DSI loads served in this manner will *not* be eligible for an allocation, nor that the power available to preference customers under an allocation will *not* be reduced to provide power to the DSIs. And it is reasonable to expect that DSIs being served by local utilities will demand just such treatment when the topic of allocation is ripe. This will put the supply of federal power available to all preference customers at risk.

<u>Regulatory Role</u> – The straw proposal indicates that BPA will only make the subsidy payment available when it supports actual operations that provide employment, and will be based on BPA's evaluation of past DSI performance and its clear understanding of each DSI's business plan. The straw proposal describes these as eligibility criteria.

These criteria place BPA in the role of judging which DSIs have an adequate business plan, and those that do not. This is simply an untenable position for BPA, as it will likely find itself incapable of judging based on these criteria, let alone disqualifying a DSI. BPA should not place itself in the position of judging which DSI should get power, and which should not.

<u>Conclusion</u> – The straw proposal is aimed at reducing the risk faced by BPA in serving the DSIs. While this is an admirable goal, the mechanism chosen by BPA is ill-advised.

The transaction in the straw proposal is too complicated, requires that existing policies be ignored, and is based on transactions that are beyond BPA's legal authority. If BPA insists on continuing to provide a subsidy to the DSIs, it should do so in a manner that is soundly within its statutory authority. And while it should make every effort to minimize the risks involved, BPA must recognize that at the end of the day, doing business with the DSIs is, given the world aluminum market, inherently risky.

4. An Alternative Approach for a DSI Subsidy

The WPAG utilities believe that given the historically high level of BPA rates to its preference customers, it is time to bring the subsidies to the DSIs to an end. However, if BPA feels compelled politically to subsidize this increasingly risky and uncompetitive industry, rather than a complicated financial transaction that is based on a sham power sale that violates the NLSL policy, BPA would be better served by structuring the DSI subsidy as a power sale with the following characteristics:

- BPA would make a power sale directly to any requesting DSI. There would be no eligibility criteria.

- Periodically (quarterly or semi-annually) BPA would request load commitments from all DSIs for the next load commitment period (a quarter or one-half year). Each DSI would decide the amount of power it wished to purchase, and would contractually commit to such purchase for the load commitment period at the DSI rate, which would be equal to the PF rate.

- The amount of money spent by BPA on the DSI power supply for each load commitment period would be limited to the product of the DSI revenues for the purchase period plus $40 million for a one year commitment period, $20 million for one-half year, or $10 million for a quarter, depending on the length of the load commitment period. (DSI rate x load commitment + $40/$20/$10 million). The amount of power purchased would vary based on the market price of power and the level of the DSI load commitment.

- The DSI contracts would contain credit-worthiness provisions identical to the current Block/Slice contract, and would require payment at the start of each month prior to delivery of power.

- Once the load commitment has been made, the DSI power purchase obligation would be take or pay, meaning that a smelter could reduce its deliveries below its load commitment level or to zero, but would remain financially liable for the power committed to for the load commitment period. BPA would market the undelivered power, and credit the DSI any proceeds of such sale up to the level of the DSI rate.

This approach places an understandable limit on the DSI subsidy, avoids conflict with existing BPA policy, and is a transaction that is well within BPA's authority. It keeps

BPA out of the regulatory role, and puts the decision making clearly where it belongs, which is with each individual DSI. And while this approach does not guarantee the survival of all DSIs, it gives all an equal chance.

The WPAG utilities urge BPA to consider seriously this approach.