From: Jack.Speer@alcoa.com
Sent: Wednesday, January 04, 2006 10:18 AM
To: BPA Public Involvement
Subject: Comment on BPA's Service to DSI Customers

Attachments: Alcoa Comment on DSI Prototype.doc
Comment on **BPA's Service to DSI Customers**
View open comment periods on http://www.bpa.gov/comment

Jack A. Speer
Alcoa Inc.
Jack.Speer@alcoa.com
(509) 663-9331
6200 Malaga Alcoa Highway
Malaga WA 98828
Attached please find Alcoa's comments on the Prototype DSI contract. The original version has been sent to Paul Norman via US Mail. Jack Speer

This comment includes an attachment!

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

January 4, 2006

Re: DSI Prototype Contract

Dear Paul:

By your letter dated November 28, 2005, you invite comments on the DSI Prototype contract ("Prototype") that BPA has posted on its website. You also ask:

- Does the Prototype conform to the decisions and policies contained in the June 30 ROD?

- In light of the fact that when the service benefits are monetized each aluminum company DSI may obtain such benefits only if it is operating at certain minimum levels, is the level of operating flexibility provided to the DSIs in the Prototype reasonable? Should DSIs have access to benefits at lower minimum operating levels than discussed in the ROD, or higher levels? Should BPA maintain the $59 million annual limit or should smelters be given additional flexibility to draw benefits early from future fiscal years?

On behalf of Alcoa, I want to thank you and your staff for your professional and considerate conduct throughout these long proceedings. While we continue to believe that your fundamental approach is wrong, we do appreciate that you have given all stakeholders ample opportunity to participate.

While Alcoa offers these comments on the contract as proposed (in the final paragraphs of this letter), as you know, Alcoa believes that BPA should, under the terms of the Northwest Power Act, offer Alcoa actual power service, rather than a level of monetary benefits that will surely be insufficient to: a) keep both of Alcoa's remaining Northwest smelters in operation, and b) meet BPA's legal obligations.

Alcoa is very concerned that BPA is responding to public pressures in determining how it will serve the DSIs in lieu of dispassionately applying the law. This should not be a popularity contest. Alcoa appreciates BPA's expressed desire to achieve the greatest probability of promoting sustained operations of the DSIs, within a capped cost. However the establishment of a monetary benefit in lieu of power delivery puts the company at odds with other BPA customers. More importantly, the level of the benefit in BPA's proposal will keep the smelters (and the associated regional jobs) in jeopardy.

Alcoa owes it to its employees and those dependent on Alcoa's smelting operations indirectly to make the consequences of this decision clear. Alcoa finds BPA's proposal to be fundamentally flawed because it will in all probability not sustain even today's level of regional operation.

Alcoa Is A Long-time Customer Who Has Helped Build BPA's System

Alcoa has been a BPA customer ever since Administrator Paul Raver signed a contract with Alcoa on December 20, 1939.[1] In the ensuing 66 years, Alcoa has consistently bought power from BPA. In the aggregate, the DSIs constituted about one-third of BPA's load and paid BPA revenues for power that permitted BPA to amortize its system. The DSIs, until the last four years, have always been a substantial part of BPA's loads and revenues. For example, in 1942, the DSIs accounted for 92 percent of BPA's power commitments[2]. Based on $7.5 billion in Treasury amortization repayments since 1940, one can easily estimate that the DSIs have paid BPA amortization of approximately $2.5 billion. To say that seeking power from BPA is to seek a larger "subsidy" (as some BPA customers have suggested) ignores the substantial equity in the BPA system that Alcoa and the other DSIs have contributed over the years. Alcoa was one of BPA's first customers, consistently paid its bills, and like other valuable BPA customers, has an equitable claim to BPA power service.

DSI-Installed and DSI-Paid Conservation And Load Reductions Have Enabled Other Regional Loads To Be Served

During recent meetings on the Regional Dialogue, there has been broad customer support for 1) treating public body full requirements customers as a pool so as to allow the aggregate High Water Mark loads to be "shared" between customers, and 2) to not penalize net requirements customers for the conservation they have achieved by allowing those customers to remove an amount of declared resources equal to the conservation achieved. To avoid undue discrimination, these same principles should be applied to the DSI loads.

Aluminum DSIs have achieved substantial conservation though improved process efficiency over the years, and have paid for approximately one-third of the conservation that BPA has paid for on utility systems. To be fair and consistent, these conservation achievements should be considered when determining how much power BPA has to serve the DSI load as this "resource" has been paid for by the DSIs.

In addition, as BPA has recognized, DSI loads have been declining dramatically. BPA's Record of Decision recognizes that DSI loads have declined from over 3000 MW, pre-1995, to 2000 average megawatts post-1995, to 1500 average megawatts in the 2002-2006 period (with actual deliveries being much lower)[3]. BPA's decision to further reduce

[1] Bonneville Power Administration, *Columbia River Power For The People*, p. 123 (1981).
[2] Id.
[3] BPA Record of Decision at 2.

the imputed load for determining DSI benefits down to 577 megawatts is an arbitrary reduction that assures that the remaining DSI loads cannot adequately be served. To operate its Intalco and Wenatchee smelters at historic levels, Alcoa needs 625 megawatts of BPA power. BPA has recognized that Alcoa asked for 438 average megawatts of power as a bridge between 2007-2011 contracts and contracts for the period after 2011.[4] It is clear that the DSI load reductions have permitted the region to meet growing public agency loads (and to allow regional utilities, including BPA, to make very lucrative sales outside the region). BPA should give the same treatment of aggregating historic loads to determine how much DSI load can be served by BPA just as BPA proposes to give to public agency requirements customers, limited by the actual DSI loads still capable of being served within the region. Viewed in this way, BPA would be adjusting its service obligations downward to match the actual DSI demand limits for smelters that continue to operate instead of adopting artificial constraints on those loads based on some level of perceived political acceptability.[5]

BPA Has Surplus Power To Sell The DSIs

Based on BPA's own estimates of loads and resources, BPA has sufficient surplus resources (in excess of net requirements) in 2006 through 2008 to serve all of the 560 megawatts of load BPA proposes in its ROD to aluminum DSIs. Instead of providing a limited monetary benefit to the DSIs that might or might not be sufficient, BPA could provide 560 MW of firm power to the DSI loads. Under anything but critical water conditions, BPA has a large amount of surplus power that extends out well into the future beyond the term of the present 2007-2011 contracts that BPA is offering the DSIs. BPA could use this surplus (and under the requirements of Regional Preference is required to use this surplus) to serve the DSI loads. Instead of granting monetary benefits to the DSIs, BPA could be serving the DSIs with available surplus firm resources that would be available in most years.

BPA Is Required To Use This Surplus To Serve Regional Loads--Including the DSI Load.

---

[4] BPA ROD at 6.

[5] It is not BPA's province to attempt to achieve "political balance." That is the job of Congress, as expressed in statute. BPA's ROD states:

> "BPA noted this amount of benefits was in line with the level of support many non-DSI customers had indicated in previous comments they were willing to support and that the proposal struck a reasonable balance between supporting DSI operations and attendant jobs and the need for BPA to contain costs."

The foregoing observation illustrates the problem: Rather than applying the law, BPA is seeking to achieve its own perception of the right political balance. But achieving the correct political balance is the job of Congress through Public Law 88-552 and the Northwest Power Act which, taken together, assure continued power service to the DSIs, at the very least while BPA is able to make surplus sales outside the region or enable third parties to do so.

Public Law 88-552 (otherwise known as the Pacific Northwest Regional Preference Act) was passed in 1964 in order to permit the construction of the Pacific Northwest/Southwest Intertie. A condition of building the intertie was that power could be sold by BPA but "limited to power that would otherwise be wasted, " i.e., power "for which there is no market in the Pacific Northwest at any rate established for the disposition of such energy. 16 U.S.C. § § 839f(c); 837(c)."[6] BPA's ROD repeats several times that service to the DSIs is discretionary. We see nothing discretionary in providing service to the DSIs when BPA has power available and the DSIs have requested such service.[7] The DSIs have a statutory right to power that is clearly secondary to preference customers' rights, but nonetheless is expressly established in the Northwest Power Act at Section 5(d).

BPA may believe that the Ninth Circuit Court of Appeals has sanctioned BPA offering power to the DSIs at market based rates under Public Law 88-552, and that, therefore, during periods of time when there are high market prices for surplus firm power, the DSIs would be unable to operate if power was offered at the market rate. In *Kaiser Aluminum & Chemical Corporation v. Bonneville Power Administration* the Court sanctioned the sale of power to the DSIs at the FPS rate rather than the IP rate. But that happened in circumstances in which the DSIs had relinquished their IP contract rights and thus were seeking to purchase surplus firm power to supplement their own market purchases. In the Regional Dialogue, Alcoa asked BPA to provide it with a firm power contract. It has not chosen to purchase in the open market--but instead asks BPA to provide it with power that is surplus to the needs of its other customers at a statutorily required, cost-based rate. Under present circumstances, Alcoa believes that it is entitled to power service at a fixed, cost-based rate.

As Alcoa has previously expressed to BPA, it is not aware of any other customer in the United States that is unable to request power service from a utility that is entitled to serve that load. If BPA is unwilling to provide power service to the aluminum DSIs, then it should, as it has done for Port Townsend Paper Company, permit public entities to serve the DSI load based on a sale of BPA power at the PF rate to the publicly-owned utilities adjacent to the aluminum smelters, with a reasonable margin to the publicly owned utility. Surely the decision not to provide the DSIs <u>any</u> power cannot be said to meet BPA's obligation under the Transmission System Act to achieve "the widest possible diversified use of power at the lowest possible rates."[8]

<u>BPA Should Not Discriminate Against the Aluminum DSIs</u>

BPA has proposed, in its ROD, to provide to Port Townsend Paper Company (a DSI) 17 average megawatts of power "through the local public utility" at a price

---

[6] *M-S-R Public Power Agency v. Bonneville Power Administration*, 297 F 3d 833 (9th Cir. 2002).
[7] Id. at 75 ("Bonneville violated Congress's directive [in the Excess Federal Power Act]by treating power it refused to sell as power the DSIs elected not to purchase.").
[8] Federal Columbia River Transmission System Act, Section 10, incorporated by reference into Section 7(a)(1) of the Northwest Power Act, 16 USC § 839e(a)(1).

approximately equivalent to, but in no case less than, its lowest-cost PF rate. This is the same type of service Alcoa has requested from BPA. Alcoa believes that the proposed service to Port Townsend makes a good deal of sense, not only for Port Townsend, but for all of the remaining DSIs. BPA's contracts for power are to "encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles…on fair and reasonable terms and conditions."[9] The "fair and reasonable terms and conditions" standard is very much like the "just, fair and reasonable" standard which has been held to prohibit discrimination in rates. The Bonneville Power Act itself requires that "rates for resale…to the ultimate consumer shall be at rates which are reasonable and nondiscriminatory."[10]

Alcoa urges BPA to sell power to DSIs either by: (1) making a direct sale of power to all of the remaining DSIs using the PF rate plus a reasonable margin, or (2) by making a sale through the DSIs local publicly owned utilities so as not to discriminate within the DSI class of customers. We urge BPA to extend the same logic used for Port Townsend to sales of power to Alcoa and the other DSIs.

Comments on the Prototype Contract

Alcoa hopes, for the reasons expressed above, that BPA will reconsider its decision not to provide electric power service to the aluminum DSIs. However, we also recognize that BPA has prepared a Prototype contract and has asked for specific input on that contract.

Alcoa wants to be very clear that if it cannot get power at a BPA cost-based rate for its smelters, Alcoa will be forced to curtail its production to zero at the Intalco smelter beginning on October 1, 2006. However, if BPA allows Alcoa to adjust its Minimum Allocation downward (below 50 percent of its Maximum Allocation), and retain the BPA benefit by utilizing the benefit at the Wenatchee smelter, there is a chance that the Intalco smelter could reopen at a later date if market prices and unused BPA benefits make additional economical power available.

We appreciate BPA recognizing, in its November 28 letter to the region, that the Prototype contract may not contain sufficient flexibility to achieve BPA's stated objectives. Indeed, with forward power prices at substantially higher rates than when BPA issued its ROD, Alcoa believes that there is a substantial likelihood that it will be unable to operate *any* of the potlines for which it receives BPA power unless Alcoa can spread the fixed benefit level over less than 50 percent of its Maximum Allocation in the contract. At current forward prices of approximately $65/MWh, if Alcoa is required to spread the monetary benefit over one-half of its Maximum Allocation; the net power rate to Alcoa will be $41/MWh. When transmission costs are added, the delivered power rate would be about $43.5/MWh--a rate that would likely not permit economic operation of any aluminum smelter in the Northwest.

---

[9] Section 5 of the Flood Control Act incorporated by reference into the Northwest Power Act, 16 USC § 839e(a)(1).
[10] 16 USC § 832d.

On the other hand, if Alcoa is faced with very high market prices, but can adjust its Minimum Allocation downward (below 50 percent of its Maximum Allocation), it can achieve net rates as low at the BPA PF rate and might be able to retain the BPA benefit by increasing its Wenatchee plant operation in the hope that market prices and unused BPA benefits will allow a future restart of the Intalco plant. Such flexibility would result in no greater than $59 million of Monetary Benefit in the aggregate, but could make a huge difference in the ability of Alcoa to keep its smelters viable. We therefore strongly urge BPA to eliminate the Minimum Allocation standard in the Prototype contract.

BPA has also requested comment on the question of whether the smelters should be given additional flexibility to draw benefits early from future fiscal years. After careful consideration, Alcoa opposes providing such flexibility. "Borrowing" from future years' Monetary Benefits could very well put Northwest smelters at a higher risk of closure in future years. This is because the fixed Monetary Benefit available to offset high market-based rates would diminish with any borrowing and therefore be partially or wholly unavailable to offset the future high prices. Moreover, Monetary Benefits can be reassigned through the Unused Benefit Amount reallocation process under Section 7 of the Prototype contract. Any "borrowing" of future Monetary Benefits would diminish the amount of future benefits that might otherwise be available to save a smelter that might not have borrowed its own future benefits. If borrowing future benefits is not permitted, and a non-viable smelter closes, the remaining future benefit could be reassigned to the remaining smelters (such as Intalco) through a reallocation of the Unused Benefit Amount. However, if the non-viable smelter closed, and had borrowed future Monetary Benefits, those prematurely-used Monetary Benefits would not be available for reallocation. Under such circumstances, a smelter that could be viable in the long term (such as Intalco) might be forced to close because the Unused Benefit Amount,that might have been sufficient to offset high market power prices for a viable smelter, is no longer available for reallocation. For these reasons, Alcoa opposes permitting the draw down of Monetary Benefits from future years.

As a customer of BPA for 66 years, Alcoa takes long-term view of the world. It wants BPA to adopt policies that will permit it to continue to operate in the region and to continue to provide jobs for its many fine employees for many years to come. Alcoa also wants to provide continued employment through the many other regional businesses that provide goods and services to Alcoa. But we can only do so if we have a reasonably-priced source of reliable power. A subsidy designed to provide far less than the amount of power needed to run Alcoa's two smelters will not allow Alcoa's Northwest smelters to be viable in the long run, particularly if rigid operating constraints are imposed. Alcoa does not look to BPA for a subsidy. It merely requests that BPA provide it with cost-based power, either directly or indirectly through its publicly owned customers. If Alcoa cannot remain viable based on such cost-based rates, then regrettably, it may have to close its smelters. But any such decision should be made after Alcoa has been provided a fair chance to operate based on its long-standing relationship with BPA. That decision

should not be made on the basis of BPA's efforts to achieve a politically acceptable result, but should instead be based on a straightforward attempt to comply with the law.

We appreciate the opportunity to file these comments and look forward to helping BPA find a way to make the remaining DSI loads viable in the long term.

Sincerely,

Jack A. Speer
NW Vice President for Government and Energy Affairs