

## Stenehjem, Carlene R - DKC

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**From:** PPC Admin [szwick@ppcpdx.org]  
**Sent:** Friday, January 06, 2006 2:57 PM  
**To:** BPA Public Involvement  
**Subject:** PPC comments on DSI Draft Prototype Contract  
**Attachments:** PPC DSI contract comments 1 5 05 \_2\_.pdf

Attached are Public Power Council's comments on BPA's Draft Prototype Block Power Sales Agreement for service to the aluminum smelter DSIs. Thank you for the opportunity to comment.

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January 6, 2006

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**Re: DSI Draft Prototype Contract**

Mr. Norman:

On behalf of the Public Power Council (PPC) and its members, we submit the following comments on the Draft Prototype Block Power Sales Agreement for service to the aluminum smelter DSIs, released by BPA on November 28, 2005.<sup>1</sup>

***BPA's Reconsideration of DSI Benefit Levels***

In the June 30, 2005, DSI Record of Decision (DSI ROD), the Administrator stated that he would reconsider his decision to offer up to \$59 million per year of benefits to the aluminum smelter DSIs after the cost of Judge Redden's June 10, 2005, injunction became more clear. In a November 28<sup>th</sup> letter, BPA confirmed that its review of the level of DSI benefits would include consideration of other costs resulting from litigation over the FCRPS Biological Opinion that are expected later this year. Since that time, BPA has determined that the June 10, 2005, injunction cost the agency approximately \$74 million in lost revenues, and that implementation of Judge Redden's most recent order could cost even more. In light of these costs, we begin our comments with the strenuous assertion that the Administrator should amend his June 30<sup>th</sup> decision, and not offer the aluminum smelter DSIs \$59 million of benefits.

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<sup>1</sup> Although your letter accompanying the Prototype Contracts stated that comments were due to BPA by January 4, 2005, in a December 8, 2005 email from Allen Burns, at your direction, we were granted until January 9<sup>th</sup> in order to accommodate our board meeting and for other reasons. We thank you for allowing us this extension of time.

While we are grateful that the agency has decided to conduct a top-to-bottom review of its costs in light of these litigation costs, we take exception to the statement in your November 28 letter that BPA will reconsider the DSIs' benefits "before the rest of the cost review is completed so that the DSIs are able to make a timely commitment . . ." We assume that the purpose of BPA's cost review is to determine the financial status of the agency and reassess its spending decisions, including the DSI benefits. We believe it is irrational for BPA to determine whether spending \$59 million on the DSIs is good policy before BPA knows its total financial picture. Making the decision any sooner than completion of its cost review means that BPA is exempting the DSIs from sharing in the risks of Judge Redden's decisions along with all of BPA's other beneficiaries and customers. We therefore ask that BPA wait at least until completion of its cost review in April before offering the DSIs the contracts.

Regardless of the timing of the Administrator's decision on DSI benefits, we urge BPA to make good on its promise to consider revising the DSIs' benefits in light of dramatic cost changes. A reasonable revision would be to make the level of DSI benefits contingent on the absence of events dramatically affecting BPA's rates. For example, as costs resulting from litigation over the FCRPS are incurred, BPA should reduce the DSIs' benefits accordingly. Since the DSI benefits are offered at the expense of preference customers and are, according to BPA, discretionary, it is inappropriate to provide the DSIs a guaranteed level of benefits when preference customers have no such guarantee. The Prototype Contract should include a mechanism to adjust DSI benefits in response to present and future costs.

### ***Monetary Benefit Provisions***

To the extent that the Administrator offers the DSIs benefits in the '07-09 period, we agree with the agency's decision to make those benefits monetary, because such an arrangement is lower-risk than an actual power sale.

We support the Administrator's determination to cap the DSIs' benefits by not allowing them to receive an effective "rate" that would be lower than the PF rate. Regarding enforcement of the cap, however, the Contract should be strengthened in the following respects.

Section 6(c) states that the DSI must notify BPA if it has procured power at a sufficiently low cost that this power, along with the DSI's monetary benefits, allows it to serve its annual load at a rate that is effectively lower than the PF rate. The DSIs' benefits are capped at that point. In addition to this obligation of the DSIs to notify BPA of when that cap is reached, BPA can ensure compliance by requesting access to documentation from the DSIs "within 90 days" following the end of each contract year. If BPA discovers that a DSI has received a greater benefit than it is entitled to, the Contract states that the DSI

owes BPA for the difference, and that BPA will reduce the monetary benefits in the following year to recover the overpayment.

We see a couple of weaknesses in this construct. First, the Contract's primary enforcement of the cap is through a reliance on the DSIs' reporting to BPA that they have reached it. While we would like simply to trust that the DSIs would diligently adhere to this instruction, we believe it is a poor contractual arrangement to rely on the party that stands to benefit from an overpayment to report it. We also think the Contract fails to clarify what constitutes "knowledge" by a DSI that it has exceeded the cap.

Second, although the Contract provides BPA with the ability to audit the DSIs' compliance, the audit can only be done after the end of the contract year, and appears to be discretionary in any event. If an overpayment were occurring during the year, the amount of overpayment could be substantial by the time it is discovered by BPA. This problem is not alleviated by the Contract's allowance for BPA to adjust future DSI payments to recover the difference or to bill the DSI directly, since if the DSI fails to operate, enters bankruptcy, or declines the future benefit without termination of this agreement BPA may not be able to recover overpaid amounts.

We think these problems should be addressed by amending the Contract to provide that BPA will conduct at least quarterly audits of the benefits being received by individual DSIs. This would allow timelier discovery of any overpayments, and would increase the likelihood that BPA could fully recover any overpaid amounts.

### ***Power Sale Provisions***

An actual power sale to the DSIs, for which BPA has allowed the possibility in the 2010-11 rate period, carries far more risk than monetized benefits, as described in the June 30 ROD. The DSIs' preference for physical power benefits is easily understood—a power purchase from BPA at a fixed rate is effectively a hedge against increases in market power costs for the DSIs, with BPA and its customers bearing the risk. If the DSI rate is set at the \$59 million cap at the beginning of the '10-'11 rate period, there is a risk (borne by BPA and its other customers) that market prices would increase such that BPA's actual costs would exceed \$59 million per year. We suggest that to the extent BPA provides benefits to the DSIs at a capped amount, monetizing the transaction is a better approach.

However, since the Contract currently gives BPA the ability to convert the DSI benefits to an actual power sale, we offer the following comments on those provisions:

## The Contract Should Define the “Cost” to BPA of the Power Sales

The Draft Prototype Contract provides that the physical power sale is subject to a rate defined in Exhibit A. Exhibit A then states that it will be unilaterally revised by BPA to include the applicable rate, and that the rate “will not exceed the cost caps as described in the Administrator’s Record of Decision.” We believe that this is an insufficient guarantee that the costs of serving the DSIs under these provisions would be limited to \$59 million per year.

It is difficult to ascertain what BPA defines as its “cost” by looking through the DSI ROD. However, it appears that the agency is considering its cost to be the difference between the DSIs’ rate and the forward market price forecast for the year. In other words, it appears that BPA will deem its costs to be \$59 million if the difference between the DSIs’ rate and the market price it projected during the rate case, multiplied by the DSIs’ load, is \$59 million – without regard to actual market prices during the rate period. If market prices were to rise during the rate period, BPA would likely incur actual costs that exceed \$59 million, since “BPA’s secondary surplus has an opportunity cost value equal to the market value as that secondary is produced.”<sup>2</sup> This risk is in addition to risks associated with any power supply contracts BPA might have entered into to supply the DSI load.

We believe a better definition of the “cost” that DSI power sales must not exceed is the difference between the DSIs’ rate and the actual market costs of power. This definition of cost should be incorporated into the Contract, and BPA should monitor the actual costs experienced by BPA in the rate period, month-by-month or quarter-by-quarter. This provision would ensure that the cost cap would not be exceeded in the event that the Contract is converted to an actual power sale. Another alternative BPA should explore is setting the DSIs’ rate at a specified amount below an updated market forecast, instead of a fixed market forecast.

We note that in the June 30 ROD, BPA recognized that “[t]he only clear way to eliminate the risk of breaching the cap due to escalating market prices . . . would be through a contract provision that excused BPA from providing the DSI with power as soon as BPA had incurred costs equal to the DSI’s annual allocated share of the cost cap.” The ROD then states, however, that such a provision would be “impractical for a number of reasons, leaving BPA under some circumstances with residual remarketing risks, and creating too many operating uncertainties for the DSI.”

We do not agree with BPA’s reasoning that such a provision would create “too many operating uncertainties for the DSI” since we agree with BPA’s own

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<sup>2</sup> See DSI ROD at 23.

statement in the DSI ROD that the agency should not be attempting to “guarantee any particular level of DSI operations, even minimal levels.” A contract provision excusing BPA from providing service to the DSIs once BPA’s actual costs exceeded the cap is not only reasonable, but is a major part of the deal BPA described when it justified these benefits to regional ratepayers and the congressional delegation.

### The Interruption Rights Do not Provide Adequate Risk Protection

The Draft Prototype Contract contains a provision designed to ameliorate some of the risks of an actual power sale to the DSIs. Section 4(i) gives BPA the one-time right to stop delivering power to the DSIs if BPA’s market forecast exceeds \$125/MWh. However, BPA can only do so after 90-day notice to the DSIs. During those ninety days, BPA could incur substantial costs. Also, BPA must resume power deliveries after one year, at which point BPA might then continue to incur those costs. We know that BPA is well aware of the risks of a power sale to the DSIs, but we want to communicate to you that we find Section 4(i) to be wholly insufficient as a DSI benefit risk-mitigation strategy. The Contract should provide for much shorter notice periods, and should not require BPA to resume service at all if market prices remain high.

We have another concern about the interruption rights provided in the Contract. The Contract gives BPA “sole and exclusive discretion” to determine whether or not “average forward market prices” will reach \$125/MWh. Once BPA makes such a determination, it can interrupt service to the DSIs, but then must pay them \$24/MWh for the amounts interrupted, with that money going to pay the DSIs’ employees during the interruption. This makes possible a situation in which BPA pays the wages of DSI employees for at least 6 months, or for one year, or for even longer if the parties agree, under circumstances in which the DSIs might not have had a hope of operating due to high power prices, alumina prices, maintenance problems, or other factors.

PPC does not believe that BPA should be in the business of paying DSI employees under conditions in which the DSIs are not viable. Industrial customers of preference utilities enjoy no such guarantees, and should not be asked to foot the bill for this special deal. And no-one but the DSIs – neither BPA nor its customers, certainly – would want to see BPA put in the uncomfortable political situation we have described above. For these reasons, we ask that BPA remove this provision from the Contract. BPA should focus on enforcing the cap on its actual costs instead of developing complex mechanisms that complicate the risk of selling power to the DSIs at a fixed rate.

## BPA Should Specify Conditions For Switching to a Power Sale

Because of the above concerns, we suggest that BPA not convert the Contract to a power sale, or that it only do so under specific circumstances that provide equal protections to its preference customers. At a minimum, we suggest that BPA should contractually state that it will not convert the Contract to power sales until after it conducts a public comment process, in which the preference customers could participate.

### ***Flexibility Provided in the Contract***

In your letter, you asked whether the DSIs should be given the option of greater flexibility in drawing benefits from BPA, either by raising the minimum MW or allowing the DSIs to draw benefits early from future fiscal years. PPC feels strongly that these would be unwise allowances and inconsistent with the DSI ROD. Allowing the DSIs to draw benefits from future years would function simply as an increase in the \$59 million annual limit, since DSIs could do so perpetually until the day they discontinue operations, at which time requiring them to return borrowed “future benefits” would be problematic and unlikely. Such a provision would undermine the risk protection which makes the financial benefits option desirable in the first instance. Our understanding from the DSI ROD was that BPA will offer the DSIs an annual stipend, not a lump sum. Allowing them to “draw early” makes their benefits resemble the latter.

### ***Other Issues***

Finally, we take the opportunity to raise a number of issues related to legal concerns we have about the Contract:

#### Rate Protections Under the Northwest Power Act

Section 7(b)(2) of the Northwest Power Act puts a ceiling on the amounts that BPA can collect from its preference customers through rates. Section 7(b)(3) then provides that BPA costs exceeding the ceiling must be collected from other customers. Those “other customers” include the DSIs. This Draft Prototype Contract does not include a mechanism for recovering costs that exceed the 7(b)(2) rate ceiling from the DSIs. We believe that BPA must provide for such a mechanism, or make certain that it can collect these amounts from some source other than the PF rate. Otherwise, BPA will have failed to provide the rate protection that is guaranteed by Section 7(b)(2).

### Creation of Rates Outside the Rate-Setting Process

Section 7(i) of the Northwest Power Act requires the Administrator to follow certain procedures when setting rates. We are concerned that this Draft Prototype Contract sets and guarantees the DSIs a rate outside of the 7(i) rate-setting process. For example, Section 3 of the Contract states that “if the Surplus Firm Power sale is monetized, then the provisions of Section 6 below establish the applicable FPS rate,” even though that rate was not established through a rate process. We prefer monetized benefits to an actual power sale, as we noted above, but we still believe that the DSIs’ rate construct should be determined in a rate case, before it is monetized.

### Provision of Reserves

Section 5(d)(1)(A) of the Northwest Power Act gives the Administrator authority to sell power to the DSIs, but states explicitly that such sales “shall provide a portion of the Administrator’s reserves for firm power loads within the region.” We recognize that BPA is proposing to sell “Surplus Firm Power” to the DSIs under the Contract, as opposed to power under the IP rate. Nevertheless, we question BPA’s ability to sidestep provisions of the Act that were intended to ensure certain benefits to the preference customers, such as the provision of reserves from the sale of power to the DSIs.

### Termination of the Contract

Finally, we note that the legality of BPA’s collection of money from preference customers for payments to the DSIs during the current rate period is being challenged in the Ninth Circuit Court of Appeals by various parties.<sup>3</sup> If BPA’s actions were found unlawful in that suit, we believe the legality of the Draft Prototype Contract would also be, at the very least, in question. An order of the Ninth Circuit Court is currently listed as an “Uncontrollable Force” under Section 11(a), but Section 11(b) then specifies that no events will be considered “Uncontrollable Forces” if the DSIs’ benefits are monetized. We therefore suggest that BPA make an order from the Ninth Circuit Court an exception to Section 11(b), and insert a provision in Section 16 of the Contract allowing it to terminate the agreement in the event that the Ninth Circuit finds against BPA’s ability to provide the DSIs’ benefits under the circumstances. This seems appropriate since BPA has inserted a similar clause already, allowing it to terminate the agreements if the Ninth

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<sup>3</sup> See Brief of Petitioners Cowlitz County, et al. and Pacific Northwest Generating Cooperative, et al., filed in *Golden Northwest Aluminum, Inc. et al. v. BPA*, Consolidated Case Nos. 03-73426 etc. We assume the agency is on notice that parties may be challenging these Prototype Agreements for some of the same reasons. See *Pacific Northwest Generating Cooperative, et al. v. BPA*, Case Nos. 05-75638 and 05-75639.

Circuit or another court finds that BPA cannot recover the costs of performing the Contract from its Slice customers.

We appreciate the opportunity to comment on this Draft Prototype Contract and on BPA's plan for reassessing the benefits it will offer the DSIs in light of recent and upcoming Fish and Wildlife costs.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Showalter', written in a cursive style.

Marilyn Showalter  
Executive Director

cc: NW congressional delegation