CANBY UTILITY

April 26, 2006

Mr. Paul Norman, Senior Vice President
Bonneville Power Administration
c/o Public Affairs Office
Routing: DKC-7
P.O. Box 14428
Portland, Oregon 97293-4428

SUBJECT: Comments on BPA's Draft Power Function Review II ("PFR II") Report Regarding the Proposed Contracts with the DSIs

Dear Mr. Norman:

Grays Harbor Public Utility District and Canby Utility jointly submit the following comments the Bonneville Power Administration's proposed 5-year contracts for the Direct Service Industries ("DSIs").

Our attorney, Dan Seligman, has submitted separate comments on our behalf regarding BPA's lack of legal authority to provide cash payments to the DSIs through their local utilities.

The comments in this letter address two related issues: the lack of proper auditing and reporting requirements in BPA's prototype DSI contract; and the availability of surplus firm power in a critical water year if BPA decides to sell power to the DSIs in the last two years of the contract. We request that BPA address both issues in its forthcoming Supplemental Record of Decision ("Supplemental ROD") on the DSI contracts.

I. BPA's Reporting Requirements and Audit Rights are Inadequate.

A critical component of BPA's proposed cash payments ("monetization") to the DSIs is that BPA will only review DSI records once a year to ensure compliance with the contract.[1]

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[1] Section 6c.

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BPA intends to use a market forecast to set the level of payments. E.g., BPA will pay the difference between the market price and the PF rate to the utilities, who in turn will pay the DSIs, subject to the annual caps. If, for example, markets are $40 per MWh, and the PF rate is $30, then BPA would pay the difference: $10 per MWh up to the individual DSI's allocation of cash benefits.

However, if the DSIs can buy power for less, then BPA will want to reduce future payments – it doesn't want to overpay the companies if the DSIs can buy power at $38, for example, not $40 per MWh.

But the DSIs will only report their sales purchases once a year, which means that BPA will play "catch up" in terms of understanding how much power and at what price the DSIs paid for power on the market.[2]

Although BPA retains the right to "audit" the DSIs (section 6c), if history is a guide, that provision will likely prove inadequate. The lessons of BPA's relationship in 2001-2003 with Longview Aluminum, L.L.C. ("Longview") are relevant here. In 2001, BPA signed a "buy back" contract with Longview in which it paid the company $226 million to reduce load for 16 months. The contract specified that Longview could use the BPA funds only for certain "qualified expenditures." Section 10. BPA retained audit rights similar to the ones at issue in the proposed DSI contracts here.

BPA took steps to ensure compliance by Longview only in 2002, after almost $200 million in ratepayer funds had been paid to the firm. When BPA demanded information, the company ignored its initial requests. When BPA persisted, it finally received critical information from Longview – ***after*** BPA had sent the last the check to the company. The information showed that Longview had apparently spent money for unauthorized purposes (i.e., life insurance policies for executives). In response, BPA appears to have done nothing.[3]

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[2] The Public Power Council expressed similar concerns in a January 6, 2006 letter to BPA.

[3] This information is now in the public domain because of several Freedom of Information Act ("FOIA") requests. See, for example, BPA responses to FOIA requests # 05-51, # 06-03 and # 06-12.

It is essential that BPA not place itself in a similar situation with respect to these contracts. We therefore request that BPA include contract language with some teeth and that it adopt strong reporting and audit requirements.

To accomplish that goal, we request that BPA include the following specific provisions in the contract:

* BPA's right and obligation to perform quarterly audits.

* The DSIs' clear contractual obligation to respond promptly to BPA. We request that BPA include language in the contract expressly requiring each DSI to comply with BPA requests for information and to give BPA the right to cancel the contract if the companies do not provide accurate, timely information.

* BPA's obligation to keep complete records on the transaction. We request that BPA commit – in the contract – to retain information in its files and to comply with federal records statutes and its own Records Manual. This may sound like an innocuous request, but in the case of Longview Aluminum, BPA now insists that it has no records (in hard copy or electronic form) of how it established the $226-million buy-back price with Longview.[4] BPA's Supplemental ROD on the DSI contracts should address BPA's record-keeping practices to ensure that federal records are properly retained.

II. BPA doesn't have surplus firm power to sell to the DSIs in critical water years.

BPA has acknowledged that it makes little sense to sell the DSIs power priced at the IP or NR rate (market) because they likely could not afford the rate. See BPA's Record of Decision on DSI Service ("Service ROD") at page 23.

Nonetheless, BPA said it wants to keep the option open to sell the companies 560 aMW of power in 2010-2011.

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[4] See, BPA response to FOIA request # 06-03.

BPA said it may supply the DSIs with surplus firm power in the last two years priced at a rate not lower than the PF rate for public power utilities. In the 2005 ROD on service to the DSIs, BPA said:

> Whether the physical delivery option is exercised will be based on BPA's evaluation of whether any credit risks of a physically delivered power sale to a company have been adequately mitigated, and whether BPA can supply the DSI load, including locking down any necessary power purchases, on a fully hedged basis at a cost at or below the cost cap. ***BPA will have this option under each power sales contract, exercisable by BPA under terms to be determined in the development of the contracts.*** " Service ROD at 23 (emphasis added).

We do not see these provisions in the current draft contract, and we request that BPA add specific language implementing the above provisions.

The problem is all the more acute because BPA's current projections show it has a sufficient amount of surplus firm power only in average years, but not in critical water years.[5] In critical water years, BPA will likely go to the market to buy power to resell to the companies – and will likely do so at a loss if market prices are higher than the price BPA proposes to charge for the surplus power.

Under those circumstances, how does BPA propose to enforce the $59-million cap? The answer is not clear from either the June 2005 Service ROD or the PFR II draft closeout report.

Nor is it clear how much power would be available even in average years if public power customers asserted their preference rights to purchase surplus firm power ahead of the DSIs.

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[5] BPA's "White Book" (revised November 2005) shows that under 1937 critical water conditions, BPA has a deficit of -18 aMW in 2010 and -126 in 2011. Under average bottom 10% conditions, BPA has only 43 aMW in 2010 and -64 aMW (deficit) in 2011. Only in average middle 80% conditions does BPA have sufficient power to sell 560 aMW to the DSIs.

We therefore request that BPA evaluate the availability of surplus firm power under a variety of scenarios and specifically address how it intends to enforce the $59-million cap on DSI expenditures under each supply scenario.

III. Conclusion

For the reasons explained in the accompanying letter from Dan Seligman, we do not believe BPA has the legal authority to provide cash benefits to the DSIs through their utilities.

If, however, BPA decides to go forward with this approach, we request that BPA strengthen the reporting and audit provisions to avoid another repeat of the Longview Aluminum mistakes.

Finally, we request that BPA carefully analyze in the Supplemental ROD the availability of surplus firm power and the potential rate impacts on public power customers if surplus firm power is not available in a quantity sufficient in 2010-2011 to supply 560 aMW to the DSIs.

Thank you for considering our comments.

Sincerely,

Dirk Borges, General Manager
Canby Utility