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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 DSI service

Dear Mr. Norman:

On behalf of Grays Harbor Public Utility District ("Grays Harbor") in Washington and Canby Utility in Oregon ("Canby"), I am submitting the following comments on the draft PFR II closeout report that addresses BPA's proposed 5-year contracts for the Direct Service Industries ("DSIs").

My clients believe that BPA has no legal authority to provide cash benefits to the aluminum smelters or the utilities in whose service territory the companies are located. The Northwest Power Act created a mechanism for BPA under certain conditions to sell power directly to the DSIs. But there is no statutory authority for BPA to provide cash to the utilities – money that the utilities must pass on to the smelters.

In essence, BPA has concocted an entirely new relationship and mechanism for attempting to keep three existing DSIs in business. BPA proposes to implement these cash payments in the first three years of the five-year contract, leaving itself the option of selling surplus firm power in the remaining two years.

We understand from talking with BPA staff that BPA intends to publish a Supplemental Record of Decision ("Supplemental ROD") on the level of DSI service.

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We request that BPA identify the specific provisions of the Northwest Power Act or other federal statutes under which BPA is acting to provide cash payments to the DSIs through their local utilities. We also request that BPA's forthcoming Supplemental ROD contain an accurate and comprehensive section-by-section analysis of the final version of the DSI contract.

A companion letter from Grays Harbor and Canby addresses two related policy issues: the lack of meaningful audit and reporting requirements in the proposed BPA-DSI contracts; and the possible sale of surplus firm power in the last two years of the DSI contract.

I. Procedural History

In February 2005, BPA published its "Regional Dialogue" proposal on its power supply role for fiscal years 2007-2011. The accompanying Record of Decision ("Regional Dialogue ROD") reached the following conclusions on DSI service:

"Although BPA has no statutory obligation to serve the DSIs, it recognizes that the DSIs have been an important part of the Pacific Northwest economy for decades." ROD at page 37.

"BPA has decided to provide some level of service benefits in FY 2007-2011 to DSIs that meet certain eligibility criteria." ROD at page 40.

"However, BPA is reserving for later decision the actual level of service benefits it will provide, the eligibility criteria it will apply in deciding which DSIs will qualify for such service benefits, and the mechanism or mechanisms it will use to deliver those service benefits." ROD at page 40.

In June 2005, BPA published its Record of Decision for service to the DSIs (the "Service ROD"). In that document, BPA analyzed three issues:

1. The actual level of service benefits;
2. The eligibility criteria it would apply in determining which DSIs qualified; and
3. The mechanism(s) it would use to deliver those benefits.

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BPA concluded that it would supply a total of 560 aMW to the DSIs, plus 17 aMW to Port Townsend Paper, and would impose a total annual monetary cap of \$59 million per year. The two caps – the amount of 560 aMW and the \$59 million – would work independently. E.g., BPA would supply less power (or less financial benefits) if the \$59 million cap was triggered, and BPA would not sell more than 560 aMW even if it could do so for \$59 million.¹

In the ROD, BPA allocated the 560 aMW to three aluminum DSIs as follows:²

1. Alcoa 320 aMW
2. Columbia Falls Aluminum (Montana) 140 aMW
3. Golden Northwest 100 aMW

BPA said it would “monetize” the payments to the three DSIs for the three-year rate period (2007-2009) based on the difference between market prices and the Priority-Firm (“PF”) power rate for public power customers. To do so, BPA would provide cash to their local distribution utility, which in turn would provide cash payments to the DSIs. Section 9(b).³ But BPA said it had not made a final decision on the cash/power option for the two remaining years of the contract (2010-2011).⁴

¹ BPA Service ROD at pages 11-12.

² BPA Service ROD at pages 17-18.

³ BPA and the utility would establish an escrow account. BPA would make payments in the account, but only the utility would have the ability to make withdrawals from the account for the DSI. (Within three days after the end of each month, BPA is required by section 9 to review the DSI’s metered load and to deposit money in the escrow account. Within 20 days following the end of the month, the utility is obligated to transfer BPA’s payments to the DSI.)

⁴ But BPA said it was inclined to sell power to the DSIs in those years. “Because the IP rate does not appear to have a high likelihood of being a viable rate for DSI service in the next [after 2009] rate period, BPA plans to offer power sales contracts in the amounts determined herein as surplus power transactions under its surplus power rate schedule.” Service ROD at page 23.

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BPA acknowledged that its goal was to help the smelters remain in business and whatever it did would likely impact public power customers, like Grays Harbor and Canby:

“At the outset, it is important to note that BPA is attempting to craft a compromise that will have a known and relatively small impact on the rates paid by its public preference customers, while still making available to the DSIs a level of service large enough to materially improve the likelihood that power costs to the smelters will be low enough to facilitate smelter operations in times when such operations would otherwise be economically infeasible.”⁵ Service ROD at 9.

On November 28, 2005, BPA requested comments from customers and other interested parties on the proposed DSI contracts that sought to implement the terms and conditions contained in the June 2005 Service ROD.

BPA accepted comments from utilities and other interested parties until January 4, 2006, some of whom questioned – as we do now – BPA’s legal authority to sign cash benefit contracts for the DSIs.⁶

On January 18, 2006, shortly after the comment period closed, BPA announced it would delay signing contracts with the DSIs and take more comments on DSI service as part of the Power Function Review II (“PFR II”) process.

⁵ Alcoa objects to calling this impact a subsidy. “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.” See, Alcoa comments to BPA of January 4, 2006, page 6. But public power customers will pick up the tab for the proposed DSI transactions, as BPA has properly recognized. We suggest that when one class of customers pays for the cost of serving power or supplying cash to another class of customers – the term “subsidy” is appropriate. Call it what you will, somebody pays, and that somebody is public power.

⁶ See, for example, the comments of PNGC Power (January 4, 2006): “[I]n both the Regional Dialogue ROD and the DSI Service ROD, the Administrator failed to identify any legal authority for doing what the prototype contract does with respect to DSI Service: (1) at least for the first three years, commit BPA to doling out huge subsidies to DSI customers by ‘monetizing’ the benefits of heavily discounted surplus power sales...”. See, also, the comments of Snohomish Public Utility District (January 4, 2006): “Finally, but most important, BPA has no statutory authority to provide financial subsidies of the type proposed in the DSI prototype contracts.”

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BPA explained:

"Several comments requested that DSI benefit levels be included in BPA's Power Function Review II, which is scheduled to kick-off on January 23, 2006 and conclude April 2006. *BPA has agreed to this request.* Subject to the outcome of this review, BPA now expects to sign the DSI contracts (assuming they are offered), at the end of April..." (Emphasis added.)
www.bpa.gov/power/pl/review/announcements.shtml

On April 4, 2006, BPA released its PFR II draft closeout report, which concluded the "indirect" cash payments were its preferred course of action. "...BPA believes that the indirect [cash payments] approach best meets our dual goals of broadly applying rate adjustments and providing benefits to support DSI operations."⁷

II. BPA's PFR II Draft Closeout Report

In the PFR II draft closeout report, BPA reaffirmed its earlier preliminary decision to provide cash benefits in 2007-2009 to utilities for DSIs operating in their service territory. BPA therefore concluded it would not change the basic decisions made in the June 2005 ROD. "...BPA proposes to retain the maximum DSI benefit level at \$59 million per year."⁸ We assume that BPA's yet-to-be released Supplemental ROD will be the final agency action on the matter.⁹

⁷ BPA PFR II draft closeout report, page 9.

⁸ BPA PFR II draft closeout report, page 9.

⁹ BPA's prior determinations in the June 2005 Service ROD and the draft PFR report were not final decisions with respect to the mechanism of DSI benefits. If an initial agency action may be modified or reversed during administrative reconsideration or review, it is rendered non-final while such review is pending. *Puget Sound Energy, Inc., v. U.S.*, 310 F.3d 613, 625 (9th Cir. 2002), citing *I.C.C. v. Bhd. of Locomotive Engineers*, 482 U.S. 270, 284-285 (1987), and *Acura v. Reich*, 90 F.3d 1403, 1408-1409 (9th Cir. 1996).

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The following paragraphs address the critical threshold issue that BPA must address in the Supplemental ROD.

III. BPA Has No Authority To Make Cash Payments To the DSIs

The aluminum smelters are called "Direct Service Industries" for a reason – they can buy power under certain circumstances and conditions from BPA. Under the Northwest Power Act, the term "Direct Service Industrial Customer" means an industrial customer that contracts for the purchase of *power* from the Administrator for direct consumption." 16 U.S.C. § 839a(8)(emphasis added). The DSIs are "large industrial end-users that purchase power directly from BPA instead of through a utility." *Aluminum Company v. Central Lincoln Peoples' Utility District*, 467 U.S. 380, 384 (1984).

The Act contains no authority for BPA to design a substitute benefits program that provides cash payments to the DSIs through their utilities, nor has BPA cited a single statutory reference in either the February 2005 or June 2005 ROD for the proposition that it can write checks to a local utility for the DSIs.¹⁰

Thus, BPA's proposal described in the June 2005 Service ROD and the April 2006 draft PFR II report contains an entirely new and unprecedented approach. No power will be delivered in the first three years (2007-2009).

BPA said it chose this approach because "it was unlikely that service to the DSIs under the Industrial Firm Power (IP) rate schedule would provide a rate low enough to support economic operation by DSI customers that use BPA power to smelter aluminum." Service ROD at page 2.

¹⁰ The proposed DSI benefits program therefore looks quite like the IOU cash benefits program now under review in the Ninth Circuit in the Subscription and "Settlement Lite" cases. Citation, *Portland General Electric v. BPA*, docket 01-70003, and *Public Utility District No. 1 of Snohomish County v. BPA*, docket 04-74240.

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BPA's proposed contracts undermine the basic tenets of the Northwest Power Act that allowed the DSIs to become direct power customers of BPA. In their rates, the DSIs were to pay for the cost of the Residential Exchange Program until July 1, 1985. 16 U.S.C. § 839e(c)(1)(A). After that date, BPA was required to set rates "at a level which the Administrator determines to be equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region." 16 U.S.C. § 839e(c)(1)(B).

Courts have long held that an agency's authority depends on a valid grant of statutory authority. *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000). When Congress speaks directly to an issue – in this case, BPA's obligations to the DSIs – it is not within the power of the agency to substitute a program of its own making.

We have therefore concluded that BPA cannot undermine the carefully-crafted compromise of the Northwest Power Act by dispensing cash to the smelters under the guise of economic development or job preservation.

We understand the importance of job retention in rural communities and the impacts of plant closures. Grays Harbor has faced similar conditions itself, and has seen the closure of several plants and the loss of valuable employees.

No one wants to see smelters shuttered or jobs lost. But BPA's mission is not to promote economic development of certain favored industries. Its statutory power marketing functions do not include authority to dole out federal funds to select industries.

IV. BPA's Supplemental Record of Decision Should Contain an Accurate Section-by-Section Analysis of the DSI Contracts

BPA has posted a prototype DSI contract on its web site but has said several provisions may change in the final version offered to the companies.

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We request that the BPA's Supplemental ROD contain a section-by-section analysis of the key provisions and why BPA selected a particular approach over alternatives proposed by utilities and others who submitted comments on the draft contract and/or on the PFR II draft closeout report.¹¹

V. BPA's Proposed Port Townsend Paper Contract

Also on the table in the PFR II process is a small (17 aMW) power sales contract that BPA proposes to execute with a non-aluminum DSI, Port Townsend Paper. BPA has decided to make Port Townsend Paper the exception to the rule: it proposes to sell the company power between 2007-2009 and not to monetize the payments.

BPA has posted two draft prototype contracts on the web for comment. The first involves a three-party arrangement between BPA, the company and the local utility, Clallam County Public Utility District ("Clallam"). The second contract involves a direct sale of power to Clallam earmarked for Port Townsend Paper.

¹¹ The importance of having an accurate section-by-section analysis in the ROD is best illustrated by BPA's actions during the mid-1990s, when it signed "Block Sale Contracts" with the DSIs. Under the provisions of the contract, the DSIs had two options for mitigating their take-or-pay obligations. Under the first option, the DSI would pay BPA a curtailment fee. Under the second option, the DSI could instruct BPA to remarket its unused energy. BPA would pay cash to the DSI if the remarketed power exceeded the value the DSI would have paid BPA under the established rate. Section 18(b)(4)(D). BPA's Record of Decision, however, made no mention of BPA's contract obligation to pay cash to the DSIs. Instead, the ROD inaccurately referred to BPA's obligation as a simple matter of giving them a credit on their power bill. See, "Administrator's Record of Decision: Direct Service Industrial Customer Requirements Power Sales Contract" (September 28, 1995) at pages 12-13. Then, in 2000-2001 during the West Coast energy crisis, several DSIs exercised their contract rights and asked BPA to sell their unused power on the market, receiving about \$1.2 billion in cash. Had the DSIs only received \$1.2 billion in "credits" - as the ROD stated - the DSIs would have had to keep operating their smelters in the Pacific Northwest in order to obtain the value of the remarketing proceeds. Instead, at least one company, Kaiser, "took the money" and ran, shutting down its smelter. The point here is that we seek to avoid a repeat of that situation. BPA needs to publish a ROD that accurately describes each major contract provision.

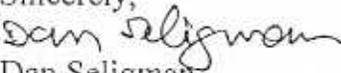
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In the Supplemental ROD, BPA should clearly answer the following questions:

- * Why has BPA proposed a power sale only to Port Townsend Paper?
- * Why did BPA structure the agreement with Clallam rather than selling power directly to the company?
- * Does this transaction create any precedent for surplus firm power transactions with other DSIs? We note that Port Townsend Paper is physically located in Jefferson County, not Clallam County. We understand that the company has been a wheeling customer of Clallam for many years but has not purchased power from Clallam. Does BPA intend to rely on this transaction to make additional surplus firm power sales to DSIs through public utility districts or municipalities in the Pacific Northwest even though the DSIs are not physically located in the counties or municipalities?
- * How and why did BPA establish the price for power to Clallam? BPA should explain the statutory authority for setting the price of the power at a level "approximately equivalent to, but in no case less than, its lowest-cost PF rate." Service ROD at 12. BPA should explain why it does not intend to price power to Port Townsend Paper at the statutory formula (i.e., with the industrial margin), as described at 16 U.S.C. § 839e(c)(1)(B).

VI. Conclusion

Grays Harbor and Canby respectfully request that BPA abandon its efforts to provide cash benefits – the "indirect" payments to the Direct Service Industries. If BPA is to provide any benefits to the smelters and other DSIs, it should be in the form of power priced consistently with the Northwest Power Act and designed to avoid subsidies to other customers. Thank you for considering our comments.

Sincerely,

Dan Seligman
Attorney at Law