Department of Energy

Bonneville Power Administration
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POWER SERVICES

March 3, 2009

In reply refer to: PT-5

To regional customers, stakeholders and other interested parties:

On February 13 the Bonneville Power Administration posted for public review and comment the draft amendment of its 2007 Block Power Sales Agreement (2007 Block Contract) with Montana-based Columbia Falls Aluminum Company and Flathead Electric Coop Inc.

We appreciate the time and effort invested by those who provided comments. I have provided BPA's responses to the comments as an attachment to this letter.

After careful consideration Bonneville has determined to proceed with the amendment to its 2007 Block Contract using the Industrial Firm (IP) power rate as the basis for a monetized arrangement directly between Bonneville and CFAC, which is virtually identical to the previous amendment agreed upon by BPA and Alcoa. We believe that both Amendments are structured in a manner that conforms with the December 17, 2008, decision by the United States Court of Appeals for the Ninth Circuit in Pacific Northwest Generating Cooperative, et al., v. Bonneville Power Administration (December Opinion). Given the existing circumstances, we also believe that monetizing the sales is appropriate and in accord with the December Opinion.

BPA will separately address the FY 2010-11 period under the 2007 Block Contract, and will engage with the public on the terms for any amendment or replacement agreement for the FY 2010-11 period. In addition, the Administrator has stated that BPA will address any look-back issues associated with payments made under the 2007 Block Contract during the FY 2007-08 period, and intends to engage the region at an appropriate time.

Sincerely,

/s/ Paul E. Norman

Paul E. Norman
Senior Vice President
Power Services

Attachment

PSBPA'S RESPONSE TO COMMENTS:
CFAC AMENDMENT
(Effective through September 2009)

Background

The December 2008 Opinion of the United States Court of Appeals for the Ninth Circuit in *PNGC v. DOE* invalidated the Bonneville Power Administration's (BPA) monetization of its surplus power sales for direct service industrial (DSI) aluminum smelter service under contracts for the FY 2007-2011 period because the monetization was not based on the Industrial Firm Power (IP) rate. *Pacific Northwest Generating Cooperative v. DOE*, Case No. 05-75638, Slip Op. 16513 -16583 (*PNGC*). In response, BPA suspended monetization payments to Alcoa and CFAC. BPA then engaged the aluminum smelter DSIs in discussions on the possibility of amendments to conform continued smelter service to the *PNGC* opinion and possibly avoid any unnecessary interruption of smelter operations. BPA has now agreed to virtually identical amendments with both Alcoa and CFAC. Comments provided in each context are also virtually identical and so the decisions reflected in this document are equally applicable to both the Alcoa and CFAC Amendments.

Public Process

Because of the need to act quickly to avoid further economic problems for the smelters, BPA could only provide a limited amount of time for public comment on the CFAC and Alcoa Amendments, which will cover slightly more than three quarters of the current fiscal year.[1] Some of the comments have suggested that the amount of time made available was inadequate for full consideration of the implications of the *PNGC* opinion and the terms of the amendments. ICNU argues the "BPA is once again refusing to allow the region adequate time to review its Proposed Amendment." CFA 090006 at 2. ICNU also states that BPA has "made any review of the contract more difficult by only providing the new provisions and not providing a complete copy of the new contract" and concluding that "BPA has simply provided an insufficient opportunity to review the Revised PSA." *Id.*

Contrary to these assertions, BPA believes that the processes provided for public consideration of BPA's proposals have been adequate. The public has had two opportunities within almost two months to comment, one for the Alcoa Amendment and then another for the CFAC Amendment. Presumably, the commenting parties could have used some part of the intervening period to consider the Amendment more fully, particularly the implications of the *PNGC* opinion. Indeed, certain parties were obviously sufficiently convinced of the meaning of *PNGC* that they filed petitions in the Ninth Circuit Court of Appeals challenging the Alcoa Amendment.

[1] BPA has committed to a more extensive public process for DSI service for FY2010 and beyond.

As to provision of the entire contract, as suggested by ICNU, BPA did provide the entire contract, specifically identifying the provisions that had been modified as a result of the amendments. Moreover, the retained terms were the subject of public processes in 2005 and 2006, and the subject of litigation for an additional three years. To suggest that they are not readily available to the public, or that BPA has provided insufficient information, is not accurate.

Some comments also argued that prior to entering into the amendments BPA should seek a remedy for any unlawfully paid benefits in FY 2007-2008. However, such a proposed sequencing would not be consistent with the need to act quickly with respect to the Amendments, since such a process, should it be initiated at this time, could be lengthy. Moreover, *PNGC* does not require any particular sequencing of events, instead remanding the issues to BPA to determine the appropriate course. *Id.* at 16582. At this time, petitions for rehearing have been filed in *PNGC*, and the Court's mandate has not issued. Consequently, the prudent approach is to address the current exigent need of DSI survivability with contract amendments that comply with the Court's opinion, and to then, if and once the Court's mandate has issued, address the issues of whether overpayments were made and, if so, what mechanism(s) may be available to recover such overpayments, such as through offset, rate adjustment, or otherwise.

Consistency with PNGC Opinion

Several parties have raised legal issues, largely in connection with the Ninth Circuit opinion issued on December 17, 2008, in *PNGC.* As discussed below, BPA believes the arguments are inconsistent with the opinion and would lead to results that would generally prevent the Administrator from implementing key elements of the opinion and other Ninth Circuit rulings, as well as require him to ignore explicit statutory rate directives.

Requirement of Initial Offer at IP Rate

Some of the commenting parties appear to believe that, even if BPA offers to sell power to DSIs at the IP rate, that rate must recover the full incremental costs of any resources obtained to support DSI contracts. PPC, for example, concludes that its legal analysis leads to the conclusion that BPA is not justified in entering into the CFAC Amendment because "BPA calculates that doing so will result in substantial costs to its preference customers" (*citing PNGC*, slip op. at 16570, which states that "BPA has voluntarily agreed to forego revenues by charging the DSI a rate below what is authorized by statute (*i.e.,* the IP rate) and below what is available on the open market . . . and renders BPA's decision to 'monetize' the DSI contracts in an amount reflective of those underlying rate decisions—albeit a capped amount—highly suspect." PPC, CFA090005 at 2 and FN 5. *See also*, NRU, CFA090001 at 2 (arguing that "DSIs have no right to continued BPA service" and a discretionary sale must be consistent with "establishing rates at the lowest possible cost consistent with sound business principles"); SUB, CFA090003; and Canby, CFA09002.

A central holding of the Court's opinion is that, if the Administrator exercises his discretion to offer to sell power to the DSIs, any initial offer must be at the IP rate. *See, e.g. PNGC*, Slip Op. at 16539 and 16550. In support of its conclusion that any initial offer of DSI service must be at the IP rate, the Court observes that the legislative history of the Northwest Power Act "contains extensive evidence that Congress intended the IP rate to be the default price for sales of power to the DSIs." *Id.* at 16559. In this connection, the Court notes that legislative history states that "Section 7(c) prescribes the rates applicable to direct service industrial customers" (H.R. Rep. No. 96-976, pt. 1, at 69) and is the rate which "applies to all 'Industrial Firm' sales to BPA's direct-service industries . . . [for] 1985-86 *and all future [sales]*." (S. Rep. No. 96-272 at 59) (emphasis added in Opinion). The Court adds that, to the extent BPA decides to exercise its discretion to offer power to the DSIs, the *Kaiser* case "supports . . . our understanding that <u>BPA does have an obligation to offer the DSIs a cost-based rate</u>—namely, the IP rate—before declaring energy as surplus under § 839c(f) and selling it to the DSIs at a market-based—or other—FPS rate." *Id.* at 16564 (emphasis added). The "cost-based rate" referred to is not one that, to paraphrase the PPC's comment, is the rate for power available on the open market, but is rather the IP rate. Thus, the Court recognized that the IP rate is a cost based rate, *i.e.*, based on BPA's total system costs, and not a rate targeted to recover the incremental costs of resources that might be needed to replace system capability in order to support all of BPA's contractual obligations.

In addition, the Court set out the applicable rate directive. *See, id.*, at 16556, *citing* 16 U.S.C. § 839e(c) (Section 7(c) of the NPA). The section 7(c) rate directive requires that the IP rate 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). That determination of equitability is required to be based upon the rate BPA charges its preference customers, with certain adjustments. 16 U.S.C. § 839e(c)(2). It is difficult to understand, as PPC and other commenters apparently contend, how the IP rate established pursuant to section 7(c) could recover from the DSIs the incremental cost of any acquisitions required to replace system capacity in support of DSI service and still be "equitable" in relation to the rates of industrial customers of BPA's public customers, who purchase power to serve their industrial loads at the PF (preference) rates. In today's dire economy, utilities are seeking to retain industrial load, not drive it away. As the language of section 7(c) shows, it was not Congress's intent to have BPA charge the DSI customers rates that are inequitable as compared to the retail rates charged by preference customers to their industrial consumers. Rather, Congress intended to closely tie the IP rate to the PF rate.

Moreover, the criteria that Congress has required BPA to consider in developing the IP rate provide no basis for converting the IP rate to an incremental cost rate rather than a cost-based rate. Instead, the statute requires that the IP rate be based on the PF rate plus a small number of explicit adjustments, including an industrial margin less any applicable credit for the value of reserves provided by DSIs; provided that the IP rate "shall in no event be less than the rates in effect for the contract year ending on June 30, 1985." 16

U.S.C. 839e(c)(2).

This statutory rate directive specifically mandates the criteria by which the IP rate will be developed and there is no apparent legal basis to conclude that it must be set to recover the incremental cost of any acquisitions made by BPA to replace resources if needed to support DSI sales. The Court in *PNGC* understood the nature of the IP rate when it held that any initial offer of service must be at the IP rate. Slip Op. at 16539. Thus, if the comments are taken at face value, some commenting parties would require the Administrator to ignore the rate-setting directive, which would be contrary to law, or make an initial offer at a rate other than the IP rate, which is prohibited by the *PNGC* opinion. Accepting such an argument would be in direct contravention of the Court's holding in the very case being relied upon by the parties who are raising it.

The Court recognized further that BPA may make market purchases to support DSI sales: "Congress also vested BPA with the authority to acquire power, <u>including purchasing energy on the open market</u>, if needed to meet its contractual obligations . . . .[and] BPA has the statutory authority to sell power to DSIs at valid contract rates and to purchase at market rates the power to serve those contracts." Slip Op. at 16568. Additionally, in a separate Ninth Circuit opinion, the Court did not agree with the preference customers' assertion, now apparently recast in response to *PNGC*, that no costs associated with DSI service can be allocated to the preference rate:

> According to petitioners, "Entering contracts to sell power to the DSIs when BPA has none to sell them is unlawful.... The only way the post-2001 contracts with the DSIs can be lawfully performed is to require the DSIs to pay the full costs of service." In other words, petitioners asserted that BPA could not allocate to its preference customers any of the costs of purchasing power at market prices to serve the DSIs.

Golden Northwest Aluminum, Inc. v. Bonneville Power Admin., 501 F.3d 1037, 1044 (9th Cir. 2007). The Court rejected petitioners' arguments. Instead, the Court in *GNA* concluded that BPA can "use any remaining FBS resources—including FBS replacement resources—to supply its DSI customers" and BPA "is entitled to charge preference customers a rate that reflects the total cost of all FBS resources, including resources acquired to replace losses in the generation capabilities of BPA's primary resources." *Id.*

The *PNGC* Court also recognized that the IP rate, as mandated by Congress, might itself provide some level of subsidy. The Court refers to the IP rate as the rate that BPA "is statutorily required to offer" and reflects "the primary benefit that the class of DSI customers receives under the NWPA . . ." PNGC at 16579. Further, the *PNGC* Court invalidated the monetized FPS surplus sale, at least in part, because BPA was "subsidizing the DSIs' smelter operations <u>beyond what it is obligated to do</u>," *i.e.*, beyond what is provided for by Congress through the IP rate directive. *Id.* at 16572 (emphasis added). Thus, if proper application of the IP rate directives results in a benefit to the DSIs, that is simply a consequence of the NPA, and not an illegal subsidy. By the same token, if BPA acquires expensive resources to serve preference customer load growth, and those resource costs increase the PF rate, this in turn results in an increase in the IP rate due to the workings of section 7(c), which means essentially that the DSIs would share some of those expensive resource costs. That too is the way the NPA works and is not an illegal subsidy.

BPA's Interest in Exercising Discretion to Serve DSIs

Comments have suggested that BPA has not articulated a reason why its exercise of discretion to continue service to DSIs is "in accordance with BPA's duty to offer the lowest possible rates to its consumers, consistent with sound business principles." PPC, CFA090005 at 2. *See also* comments of ICNU, SUB, Canby, and NRU.

When section 9(b) of the Northwest Power Act instructs the Administrator to timely implement the Act in a sound and businesslike manner, it does so right after first charging that the Administrator "shall discharge the executive and administrative functions of his office in accordance with the policy established by the Bonneville Project Act of 1937, section 302(a)(2) and (3) of the Department of Energy Organization Act, and this Act." 16 U.S.C. § 839f(b). A great number of policies, some of them competing, can be discerned from examining those Acts, but one in particular warrants reciting here, and that is the purpose of the Northwest Power Act to "to assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply; . . ." 16 U.S.C. § 839(2). The purpose is not simply to assure preference customers of those things, or some other customer class of those things, as if they were to be the only beneficiary of BPA's actions under the Act, but to assure "the Pacific Northwest" of those things. Achieving that goal calls for a balancing of interests.

A wide variety of benefits is provided by the Northwest Power Act, not just to customers, but also to fish and wildlife and, through the Act's preference for conservation and renewable resources, the environment. The Administrator does not act in accordance with sound business principles with the view to operating as a profit-making enterprise, but rather to act in accordance with sound business principles in carrying out his myriad of responsibilities under the law, many of which evince social policies that might be viewed as inimical to acting purely like a "business." So, in the context of providing DSIs, and others, an adequate, efficient, economical and reliable power supply, it is certainly not unwarranted that BPA considers the impact of its actions on the continued viability of its customers.

BPA has, in connection with its recently proposed 2010-11 rate increase, expressed concern about the impact of the increase on consumers, particularly given the current recession and the Administration's efforts to provide a stimulus to the economy and generate jobs. Preference and other customers have now, and certainly in the past, said BPA must be concerned about the impact of its actions on consumers. Suffice it to say, the Northwest Power Act does not single out preference customers for such concern and protection, but evidences a policy of having the Administrator's actions support an economical power supply to the entire Pacific Northwest. That he is to do so consistent with sound business principles means he should support that objective consistent with sound business principles, not that sound business principles should somehow render all of these other objectives secondary or superfluous.

As noted earlier, *PNGC* affirmed that BPA has the authority, but not the obligation, to sell power to the DSIs and clarified the proper rate directives to follow in making an initial offer. BPA believes that the proposed service plan is a proper exercise of the Administrator's discretion. The decision to serve the DSI load is consistent with BPA's statutory responsibilities, including its responsibility to act in a manner consistent with sound business principles. The DSI load has provided enormous value to BPA in the past and it is reasonable to believe that it will do so again. While the aggregate DSI load has decreased substantially over the past decade due to adverse global aluminum market forces, Alcoa and CFAC have shown remarkable resilience in the face of huge challenges to remain competitive. There is ample reason to believe that they will continue to do so, if provided the opportunity to manage their costs.

DSI loads have historically benefitted BPA by taking power in relatively flat blocks that require little or no shaping; they have taken power from BPA at light load hours, when power has historically been difficult to market; and they have provided the Administrator with additional power reserves. Perhaps more importantly, BPA has in the past found it beneficial to retain the DSI load when its other loads were decreasing.

Most recently, in the 1990's, BPA was suffering significant load loss due to public customers having access to a fluid market for power that was routinely offering prices significantly less than the preference rate. Part of BPA's strategy to resolve this decreased demand was a successful effort to retain as much of the DSI load as possible in spite of the fact that BPA's cost-based rates were higher than rates for power that could be purchased on the open market. Retention of this load supported BPA's ability to meet its financial obligations in full and on time, including its Treasury repayment obligation. As the Administrator observed at the time:

> Faced with the sudden changes in the market and the resulting high likelihood that the DSIs would exercise their contractual right to remove their load from BPA on nine months notice, BPA acted to protect its overall revenues and ability to recover its costs by negotiating block sale contracts, committing the DSIs to place a substantial amount of load on BPA for five years.

Administrator's Record of Decision, 1996 Power and Transmission Rate Proposal, § 2.2 at 18; *see also, id.* § 8. Due to the many unanticipated changes that the electricity market has seen over the last two decades, it would be short-sighted and unwise to conclude that retention of DSI load could never provide significant value to BPA in the future. Due to the current economic crisis, market prices have declined significantly while BPA has just announced a proposed rate increase. No one knows what the end result of these volatile market forces will be as the economy continues to decline, nor does anyone know with certainty what market conditions will be like when the economy begins to improve.

It should also be recognized that potential load loss is not solely a product of market prices. Poor economic conditions can cause a decrease in business activity that can lead, in turn, to relocation of business enterprises and consequent population drift. Unexpected natural disasters could also affect demand for power. Currently, adverse effects in the agricultural and forest industries are anticipated due to the severe winter storms and flooding that occurred this winter. Moreover, changing technologies in the aluminum and power industries may permit DSI smelters to provide value to BPA in ways that have not yet been imagined.

It would be unwise and imprudent, in such circumstances, to refuse to provide service to customers that may provide future value to BPA as they have done in the past. In essence, such a decision would require a blind faith belief in a static and largely predictable future. Events in the power industry over the past two decades and the current economic crisis amply illustrate the folly of taking such a course. Thus, BPA sees no compelling reason, at this time, not to offer service to this statutorily-defined customer class. This is particularly true when the DSIs currently have no viable alternative for its power needs and a decision not to sell power to DSIs would almost surely have the immediate consequence of the plants shutting down and perhaps never resuming production.

BPA is certainly aware that one of the implications of providing DSI service is the impact on other rates. For this reason, the proposed service package makes business sense only because the Amendment effectively caps BPA's cost of service, and, more importantly, in the opinion of the Administrator, will not put an unreasonable degree of upward pressure on other rates. BPA's customers have not experienced a rate increase during the last six years, and service to Alcoa and CFAC under the contract amendments will have a minimal impact on rates. BPA does not believe that the proposed amendment, which covers only a nine month period at a relatively modest cost, causes unreasonable upward pressure on other rates.

Some of the comments seem to suggest that the Court will review BPA's proposal under a "highly suspect" standard. PPC, for example states: "[T]he Court's findings apply equally to the proposed amendment, and . . . BPA is not justified in exercising its discretion to sell power (or provide a monetized transaction) to the DSIs . . . where BPA calculates that doing so will result in substantial costs to its preference customers." In support of this argument PPC cites PNGC, slip op. at 16570, which states:

> BPA has voluntarily agreed to forego revenues by <u>charging the DSIs a rate below what is authorized by statute (*i.e.*, the IP rate and below what is available on the open market</u>). These foregone revenues result

> in higher rates for all other customers. This outcome is in apparent and direct conflict with BPA's statutory mandate, and renders BPA's decision to "monetize" the DSI contracts <u>in an amount reflective of those underlying rate decisions</u> . . . highly suspect.

PPC at 2, FN 5 (emphasis added). The context of the Court's use of the term "highly suspect" is relevant. The Court's evaluation focused on an Agreement based on the FPS rate where the purchase price for power was less than the IP rate. Thus, the Court's use of the term "highly suspect" was in the context of a transaction where BPA had not provided a sufficient basis for not charging the rate specifically authorized by the NPA for sales of industrial firm power. That situation does not arise in the context of offering a sale at the IP rate, which the Court has mandated must be the basis for any initial offer of DSI service. Moreover, the Court explicitly recognized that the standard of review has not been changed by its opinion: "Applying appropriate deference, we uphold the agency's assessment of whether its actions 'further BPA's business interests consistent with its public mission, so long as the assessment is not unreasonable." *Id., Citing Ass'n of Pub. Agency Customers*, 126 F.3d at 1171.

Because BPA has articulated reasons for providing DSI service that are "not unreasonable," BPA does not believe the Court will view the proposal as "highly suspect." Moreover, for the same reason, the "lowest rates possible" argument posited in the comments falls by the wayside because that provision applies to all of BPA's consumers and is not targeted exclusively on the rates paid by preference customers. Thus, the provision provides equal protection to DSI load that is being lawfully served at the IP rate.

<u>Other Issues</u>

<u>Market Price Derivation</u>

Two parties commented that it was not clear how BPA determined the market price to be used for calculating benefits under the Amendment. ICNU at 2; Canby at 2. For both Alcoa and CFAC, the market prices used to recalculate benefits for December 2008, and to calculate benefits for the period January – September 2009, are the same and were derived using the same methodology.

The general approach was to determine what BPA would have done had it taken the course approved in *PNGC* and correctly monetized the sale based on the IP rate. Specifically, for the period January – September 2009 BPA determined a forecast market price of $48.05 per MWh. This forecast was established as of December 18, 2008 ("Forecast Date"), or one day following the Court's opinion in *PNGC*. BPA uses three proprietary data sources when establishing its internal mark-to-market forward curve for a flat Mid-Columbia trading hub product. BPA's mark-to-market price curve is updated on a daily basis. BPA established the forecast market price by averaging a series of these daily mark-to-market price curves over the two and one-half month period prior to the Forecast Date during which BPA was in the market making actual purchases to meet its other supply obligations for the period January – September 2009. In other words, had BPA purchased additional energy from the market to support additional system load created by its contractual obligation to serve Alcoa or CFAC load, then BPA would have, on a forecasted basis, incurred that market price to meet those obligations as well.

As for the December 2008 recalculation, BPA used the same methodology described above to derive a market price, but since forward trading for December 2008 deliveries ended on November 28, 2008, the price curves for the two-month period prior to December cover a different number of trading days than those used for the period January – September 2009, yielding a different market price, equal to $57.48 per MWh, which BPA would have paid in the market if purchasing energy to serve the load. This method accurately reflects what it would have cost to monetize the sale based on the IP rate.

Equivalent IP

Some parties questioned BPA's use of the so-called "Equivalent IP" in calculating benefits under the Amendment, and the use of a 100 percent load factor in calculating the applicable IP rate. PPC at 3; ICNU at 2. Simply stated, the "Equivalent IP" used for calculating benefits under both Amendments for the period January – September 2009 is equal to the average IP rate over those months, as specified in BPA's 2007 Supplemental Wholesale Power Rate Schedules, using a flat (or 100 percent) load factor. This was done because (1) it is consistent with the 2007 Block Agreement in which BPA agreed that the benefits calculation would be based on the applicable average Equivalent PF rate at a 100 percent load factor, and (2) applying the individual monthly differentiated rates (for both the market price and the IP rate) is more complicated, raises the prospect of errors in administration, and will not change the total amount of benefits paid to the companies over the full Amendment period.[2] Finally, flattening out payments to the companies by using an average market price and IP rate simplifies BPA's projection of the companies' decisions regarding the level of operation as it relates to its power cost, since there is no monetary advantage or disadvantage to operating in any given month compared to any other.

In addition, with respect to using 100 percent load factor, the smelter loads have a very high load factor that in many months is nearly 100 percent, and that normally exceeds 95 percent on an annual basis. But even, for example, if BPA used a 96 percent load factor to calculate the demand portion of the IP rate for the Alcoa Amendment, the total cost of IP service for the period January – September 2009 would rise only $61,000 out of $21.5 million, or less than three-tenths of one percent.

[2] In addition, it is industry practice to book blocks of forward market purchases as an average of the prices paid for such blocks. Using that flat price for purposes of billing for sales of that same energy is consistent with that practice.

Comparison of Benefit Levels

One party asked for a comparison of the benefit level that will be provided to CFAC under its Amendment compared to the benefit level it would have received under the original 2007 Block Contract. Canby at 2. The answer is that the maximum amount of benefits that CFAC can receive under the Amendment equals $5.9 million, compared to a projected level of benefits under the original 2007 Block Agreement for the same 10-month period of $13.9 million. This reduction is primarily due to the fact that the number of megawatts for which CFAC can receive benefits is reduced from 170 aMW in the 2007 Block Agreement to approximately 91.5 aMW (the prior level of projected operation) for the months December 2008 – February 2009, and then further reduced to 37.5 aMW (a fixed amount) for the months March – September 2009. It is important to keep in mind when making comparisons between the level of benefits that may have been paid under the original 2007 Block Contract and the Amendment, that these comparisons are based on projections of the companies' level of operations.

While it was possible for CFAC to receive its maximum monetary benefit payment based on an monetary benefit rate of between $12 and $24 per MWh under the original 2007 Block Contract (depending on its level of operation), that rate is now fixed at $15.35 per MWh, or the difference between the Equivalent IP rate of $32.70 per MWh and the average market price under the Amendment of $48.05. However, payments to both CFAC and Alcoa remain subject to the $59 million cost cap originally adopted by BPA in the records of decision accompanying the 2007 Block Contract. By comparison, payment of the $16.7 million maximum monetary benefit to CFAC under the 2007 Block Contract would have been possible across a spectrum of operating levels, from as little as 85 aMW to as much as 170 aMW, whereas under the Amendment, there is not an operating level that could allow CFAC to attain a similar payment.[3]

In the case of Alcoa, BPA projects that Alcoa could receive a maximum monetary benefit of $31.9 million (if it operates at its demand entitlement), for the period December 2008 through September 2009, the same maximum monetary benefit amount as BPA projected Alcoa could receive under the original 2007 Block Contract for the same period. However, payment of the maximum monetary benefit under the 2007 Block Contract would have been possible across a spectrum of operating levels, from as little as 195 aMW to as much as 390 aMW, whereas under the Amendment Alcoa must operate at approximately 305 aMW – its demand entitlement – to receive its maximum monetary benefit. While the assumption regarding Alcoa's operating level remains the same, the formula for calculating the monthly payment amount under the original 2007 Block Agreement renders a monetary benefit rate that is close to that rendered by the equation under the Amendment.[4]

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[3] Pursuant to their respective 2007 Block Contracts, CFAC and Alcoa each received a share of the 100 megawatts that were unused and forfeited by Golden Northwest Aluminum. This brought CFAC's allocation to 170 aMW, and Alcoa's to 390 aMW.

However, absent the cost cap, in the event Alcoa operates at its full demand entitlement under the Amendment for each hour during the period January – September 2009, the $48.05 market price would result in a maximum monetary benefit to Alcoa of $33.9 million, or approximately $2 million above its prorated share of the $59 million cost cap. Therefore, Alcoa's monetary benefit limit is specified in Exhibit F of the Amendment as $31.9 million. In other words, there could be a number of hours of operation during the Amendment period for which Alcoa would not receive benefits.

Reserves

Two parties commented that the Amendment needed to provide a portion of BPA's reserves for firm power loads in the region. IOUs at 1; PPC at 4. BPA's transmission business line is contractually entitled to call on stability reserves from the companies. Prior to BPA's administrative separation into distinct power and transmission functions, with the attendant unbundling of power and transmission products, stability reserves were available to BPA through the DSI power sales contracts. The mere fact that these reserves are now made available to BPA through a BPA transmission contract rather than the power sales contract should not matter.

In addition, as described in the records of decision accompanying the 2007 Block Agreements, beginning with the 2002 power rate case and related DSI contracts for the period FY 2002-2006, BPA ceased crediting the IP rate for the value of reserves, and did not procure reserves from the DSIs under those contracts. This is due primarily to changes in the wholesale power markets which allow BPA to procure needed reserves cheaper and more reliably from sources other than the few remaining DSIs. In lieu of a fixed credit to the IP rate, in both the 2002 and 2007 power rate cases BPA proposed and ultimately adopted the Supplemental Contingency Reserve Adjustment, which established a formula, with a cap, for calculating amounts it could pay a DSI in the event that it wished to procure reserves from a DSI through separate contract negotiations. This approach was proposed, adopted, and has been implemented by BPA without objection in the contracts spanning the period FY 2002 through FY 2011. Furthermore, to the extent BPA and CFAC elect to enter into a physically delivered transaction during the final two-years of the 2007 Block Contract (FYs 2010 and 2011), there is no reason that

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[4] The formula for calculating the monthly monetary benefit payment under the 2007 Block Agreement was the lesser of the Maximum MB Monthly Payment or the amount determined by the following equation: MB Monthly Payment = ((Monthly Plant Load) x (number of hours in the month)) x (MB Rate); where the Maximum MB Monthly Payment = ((Maximum Allocation) x (number of hours in the month)) x (lesser of $12 / MWh x 0.92 or MB Rate); and where the MB Rate is determined by subtracting Equivalent PF from Forecast Market Price. By comparison, the formula for calculating the monthly monetary benefit payment under the Amendment is: MB Monthly Payment = ((Monthly Plant Load) x (number of hours in the month)) x (MB Rate); where the MB Rate is determined by subtracting Equivalent IP from Forecast Market Price. As a consequence of other Court decisions, BPA had to reduce its Priority Firm and IP rates for FY 2009 below FY 2007-2008 levels, to reflect reduced residential exchange payments to investor owned utilities, a fact that must be taken into account when comparing benefit levels.

BPA could not apply the cap and criteria in the Supplemental Contingency Reserves Adjustment provision to any cost-effective and necessary reserves it wishes to procure from CFAC. The mere fact that BPA is not receiving any reserves from CFAC during the Amendment period does not necessarily mean BPA will not procure any reserves from CFAC under the 2007 Block Contract.

Finally, BPA does not necessarily agree with the proposition that section 5(d)(1)(A) of the Northwest Power Act requires that each and every power sales contract BPA enters into with a DSI must provide reserves. The provision requires only that sales to DSI companies as a class provide a portion of BPA's reserves for regional firm power loads.[5] There is no apparent reason why this language could not be implemented in a way such that reserves are acquired from less than all DSI customers. Whether BPA will acquire reserves from CFAC, Alcoa, and/or Port Townsend during the final two years of the 2007 Block Contract has not been determined at this time although a value of reserves credit has been calculated for the initial proposal in BPA's FY 2010 power rate proceeding. In addition, as noted above, in determining the amount of reserves to be provided, BPA does so in a manner that assures the reserves are provided at least cost to BPA and its customers. Changes in the power markets since passage of the Northwest Power Act have enabled BPA to acquire reserves at a lower cost from providers other than the DSIs, and BPA believes that doing so is consistent with the intent of the Act to provide customers an economical power supply.

[5] In the 1996 rate proceeding, for example, individual DSIs were permitted to opt out of providing reserves by essentially forfeiting the value of reserves credit: "If a DSI chooses not to provide operating reserves, a billing adjustment will be made to remove the effect of the credit." 1996 General Rate Schedule Provisions at 142.