



Public Power Council Comments on

BPA Proposal for Power Sale to Alcoa

November 17, 2008 (revised)

These comments relate to the Bonneville Power Administration proposal to enter into a new 17 year contract with Alcoa to acquire power at market prices and sell to Alcoa at a price to be heavily subsidized by public utility customers. We appreciate the opportunity to comment on this proposal.

PPC has serious concerns about the effects of this proposed arrangement on the region's economy and on consumers within the service territories of BPA's priority customers. We object to the proposal because it is counter to BPA's legal mandate, fails to achieve any legitimate BPA goal, and is detrimental to the interests of the Northwest as a whole and public utility customers in particular. And, even aside from the fundamental flaws of the proposed arrangement, there are a number of practical problems with BPA's proposal.

These comments discuss the major reasons for which BPA should not pursue the proposed arrangement with Alcoa, as well as some of the specific flaws we see with the proposed construct.

The Proposal

BPA is proposing to acquire a long term power supply for Alcoa at a price of up to about 73 mills/kwh during the early years (ramping up to over 90 mills) and sell the power to Alcoa for an estimated price of about 38 mills/kwh. The cost of this "purchasing high and selling low" will be borne by BPA's public utility customers. The net cost to BPA's other customers is not fixed, but is likely to be about \$66 million per year for Alcoa (with another \$33 million per year for CFAC likely). There is no direct benefit to BPA or its customers; instead, the goal is for the community of Ferndale to retain an Alcoa-estimated 480 jobs plus any multiplier effects and the economic benefits of capital improvement expenditures. BPA estimates similar but smaller benefits at CFAC if that part of the program is carried out.

There seem to be a few rationales offered for this proposed action. First, there is the assertion of BPA's legal authority to enter into the transaction if it so desires; second, there is the assumption that ensuring jobs at Alcoa is an appropriate policy goal for BPA to engage in; and, a third contributing reason behind BPA's proposal appears to be the history of

serving Alcoa and a sense of obligation to continue. Paired with this last notion is the idea that if the DSIs had not been served directly by BPA, they might have been served by a public utility and would be getting PF power.

We disagree with these rationales and would like to look more closely at each of these factors.

The Legal Question

BPA has no obligation to provide power or any other arrangement that provides benefits to the DSIs. The Regional Act required contracts and specified rate treatment for the DSIs for the period ending in 2001, but not after that point. PPC has serious doubts about BPA's authority to enter into the proposed contracts now that the DSIs' initial contracts under the Regional Act have expired. Unlike the initial contract period, when BPA was "deemed to have sufficient resources for the purpose of entering into the initial contracts" with the DSIs, BPA does not now have sufficient resources to support a sale of power to the DSIs post-2012 without having to acquire power specifically for that purpose. If BPA's position is that it can simply acquire power in order to have enough to serve the DSIs, that position seems to unlawfully render the Northwest Power Act's deeming of sufficient resources during the initial contract period meaningless.

If BPA believes its authority to enter into a contract with the DSIs for power supply derives from the *Golden Northwest Aluminum, Inc. v. BPA* case, it should be known that the Ninth Circuit was required to assume in that case that the 2001 contracts with the DSIs were valid, and therefore did not reach the question at hand. Under this new proposal, there would be no such assumption of validity, since the proposed contracts can be timely challenged in a future proceeding if BPA proceeds with them. *See* 501 F.3d 1037, 1045 (9th Cir. 2007) ("Our analysis takes the existence of BPA's contractual obligations to its DSI customers as given; we express no independent view as to whether, or under what circumstances, section 5(d) of the NWPA, 16 U.S.C. § 839c(d), permits BPA to contract with its DSI customers once their initial contracts have expired.").

Furthermore, even if one could assume that section 5(d) of the Northwest Power Act authorized a sale of power to the DSIs post-2012, it appears that the proposed sale does not comport with the express requirement of that section that "[s]uch sales shall provide a portion of the Administrator's reserves for firm power loads within the region." *Northwest Power Act*, § 5(d)(1)(A).

The Economic Question

BPA's only real policy argument in favor of its proposal is that it preserves jobs. These jobs are of interest to all of us on a human level. Unfortunately, retaining aluminum company jobs in one community means that other equally-deserving workers in other communities in the Northwest will lose their jobs because of higher power prices utilities must pay to subsidize Alcoa.

The studies on this question (Beyers et. al., 2006; Hamilton and Robison, 2006) certainly indicate that, particularly at high power prices, the jobs gained in Whatcom County are offset by jobs lost elsewhere—perhaps with a net loss of jobs in the region. It is easy for BPA to respond to Alcoa’s appeal for help because the workers who would benefit can be identified, while the workers who would lose their jobs cannot be so easily named. While we are mindful of the impacts to the individual employees in question, this does not make the job losses of others around the region any less important or painful.

The annual subsidy of over \$140,000 per job is more than the average value of the jobs themselves. We note that a similar dollar figure of per-job subsidy was roundly criticized in the deal Alcoa struck in western New York.

With this proposal, BPA is inexcusably choosing one group of workers over another. It is not part of BPA’s mandate to choose which jobs to retain in the private sector. Apart from interfering in private sector employment, BPA is also choosing sides in private sector profitability. When BPA makes one or two companies more profitable at the expense of other industrial and commercial companies, it is interfering in the private sector in a way that is not a valid use of federal powers.

The earlier studies should be updated so that BPA and its customers have accurate analyses of job impacts. These studies, including the independent Beyer study conducted for the Northwest Power and Conservation Council and BPA, suggested that the overall effect of similar proposals on regional jobs could be negative over the long term.

If BPA wishes to continue with this questionable course of action, at the very least the previous study should be redone using up-to-date numbers. Since the primary purpose of the arrangement is to preserve aluminum company jobs, and since this will be accomplished at the expense of other Northwest jobs, everyone in the region has an interest in an accurate assessment of the impacts on all Northwest jobs.

The Historical Relationship

At the time of construction of the Ferndale plant in 1966, power was plentiful, and the flexibility of the Federal hydrosystem allowed provision of additional energy, permitting a mutually beneficial relationship where the aluminum plant soaked up surplus power, paid part of BPA’s costs and made a profit by producing aluminum. This was a business arrangement that benefited both parties. Unfortunately, the economics of aluminum production have changed over the years. Power prices in the Northwest have risen for everyone and fish restrictions mean that the hydrosystem can no longer be flexed to provide additional power to aluminum smelters. Also, other countries with lower costs have entered the aluminum market.

For the time period covered by BPA’s proposed power sale, Alcoa apparently requires power at far below market price in order to make aluminum at a profit. That means that a mutually beneficial power arrangement between BPA and Alcoa is no longer feasible and the only type of deal that would allow Alcoa to continue to run at a profit is a win-lose arrangement

with no benefits to BPA or its other customers. The fact that a mutually beneficial relationship existed in the past is not a good reason to establish a one-sided relationship for the future.

The aluminum companies did not become public utility customers but chose to receive direct service from BPA. This allowed them to deal directly with BPA on rate-setting, to receive the benefit of special arrangements from time-to-time, and to avoid the costs and uncertainties of service from utilities with their own resource costs and political issues. It is futile to try to turn back the clock and replicate what the DSIs would have had if they had chosen to be a public utility customer. Many things would have been different, not just access to PF power.

The Resource Question

Under the proposal, BPA will acquire power for Alcoa and offer it at well below what was paid for that power. This creates an artificial demand for 240 aMW of power, at a time when BPA is implementing the “Regional Dialogue” policy to limit its footprint in the market moving forward. Having BPA supply that power will have impacts beyond the economic ones.

The region is not projected to have surplus resources during the period of the Alcoa agreement so new resources will be needed for additional loads. Despite the significant development of renewable resources taking place in the Northwest, the marginal resource will probably continue to be a gas-fired combustion turbine. And even if renewables could be used to supply Alcoa, reliability would require thermal backup. The likely resulting increase in BPA’s carbon footprint is of concern to BPA’s public utility customers. An important aspect of BPA power is that it is generated using hydroelectric and nuclear resources that produce no carbon emissions. Acquisition of additional power to serve Alcoa would increase BPA’s use of carbon-producing resources.

A further practical resource question concerns the effect of a 240 aMW purchase on BPA’s ability to make other augmentation and Tier 2 purchases. BPA plans to acquire the Alcoa power before it acquires power to serve its preference customers during the same (post-2011) period. This could push up costs and decrease availability of power for other BPA customers. The impact could be particularly acute if BPA chooses to acquire some of the limited available renewables for service to Alcoa rather than allowing utilities to have access to these resources. However, it is also likely to have adverse impacts even if the acquisitions come from non-renewables. Increased purchases of any resources will diminish the availability of resources to serve other loads, given long lead times and siting difficulties for many types of resources.

Comments Regarding Details of the Proposal

In addition to the serious concerns mentioned above, there are a number of problems with the specific construct BPA proposes. A brief summary of those follows.

- The duration of the agreement is too long. Locking in this one-sided arrangement for 17 years creates too much risk, too much cost, and seems to tie the hands of future Administrators irrespective of future circumstances. In addition, the price ceilings included in the arrangement are too high.
- The proposal could result in costs even higher than BPA anticipates. Although section VIII of Exhibit A adjusts the costs of the deal over the last seven years if power purchase prices exceed the anticipated level, that adjustment does nothing to compensate for higher than expected costs that result from the IP rate being lower than currently projected.
- Under the proposal, if Alcoa fails to use the power and BPA sells it at a profit, Alcoa shares the profit. This sharing is unjustified since the risk is being borne by BPA’s customers and is another example of the one-sidedness of this deal.
- It is very important that Alcoa be prohibited from reselling the power. BPA and its other customers have previously been significantly harmed by such actions by DSIs. This must not be allowed to happen again, and should be explicitly disallowed in any arrangement.
- It is not clear what the impact on Alcoa is if CFAC chooses not to participate, even if that event is unlikely, including whether BPA is contemplating increasing Alcoa’s benefit in the event that CFAC does not accept a BPA offer.
- The requirement for more investment in a plant that may not be profitable (or only profitable if subsidized by public power) is not good policy.
- The proposal lacks a provision to ensure that Alcoa is exposed to some marginal costs so that Alcoa will have an incentive to reduce consumption, increase efficiency, and perhaps look for alternative power supply arrangements. The proposed arrangement flies in the face of the policy that BPA has been pursuing in the Tiered Rate Methodology by providing no incentive for this plant to cut consumption at the same time that BPA’s preference customers will begin to be exposed to marginal cost signals.
- The liquidated damages clause creates too much risk to customers because it does not collect the cost of flattening resources that BPA would purchase to serve the DSIs.
- BPA does not have the authority to offer payments for curtailment, and “offsets to labor costs” in the event they cannot find power. Even if BPA could be found to have the authority to sell power to the DSIs, it has no authority to offer labor offsets out of a sense of wanting to support Alcoa’s business. Additionally, the agreement does not clarify what constitutes a curtailment, and BPA could potentially be liable for \$5 million for failing to acquire power even for an hour or a day.

- The Alcoa commitment is to dollars of employment costs rather than jobs. Could Alcoa comply by giving bonuses to a few employees, while automating its systems and letting other people go? On a related note, it appears that the per-job subsidy is greater than Alcoa’s cost per job. This highlights the inefficiency of this proposal in creating jobs since the cost of creating each job is greater than the value received by the worker.
- The small carbon footprint of FBS resources is important to public utility purchasers and should not be adversely affected by the Alcoa arrangement. All utilities in the region are concerned about how power purchases could be deemed to contribute to greenhouse gas (GHG). In addition, utilities in Washington State are required to report the “carbon content” of any power purchased in any long-term agreements. If BPA acquired non-renewable resources for service to Alcoa, that could affect the properties of power sold by BPA to public customers. The proposal does not ensure that properties of non-renewables would be passed through directly to Alcoa and could instead allow for them to be blended with the FBS. Future WCI and RPS requirements are unknown at this time. During the term of the proposed sale to Alcoa carbon and GHG deemed to be part of this power agreement might well require offsets or mitigation. BPA must ensure that any future carbon or GHG impacts do not result in increases to the “carbon content” of power supplied to preference customers. Alcoa should be responsible for any GHG costs or mitigation.

Conclusion

As noted above, PPC has serious concerns about the advisability and legality of BPA’s proposal for Alcoa. In addition to the policy and legal reasons against pursuing the proposed approach, there are a number of practical problems with the specific proposal. PPC urges BPA to take the time to reconsider the appropriateness of its objectives, the unintended consequences for resource development, and the environmental impacts of subsidizing additional loads. This proposal is counter to BPA’s legal mandate, fails to achieve any legitimate BPA goal, and is detrimental to the interests of the Northwest as a whole and public utility customers in particular. Again, we appreciate BPA providing the opportunity to submit comments on this proposal. Please let us know if you have any questions.