



August 3, 2009

Allen Burns
Acting Deputy Administrator
Bonneville Power Administration

Submitted via www.bpa.gov/comment

Dear Mr. Burns,

The Public Power Council (PPC) submits these comments in response to your request for comments on the “term sheet” that BPA and Alcoa have agreed on for service after FY 2009.

Under the construct outlined in the term sheet, BPA would provide either 285 aMW or 320 aMW of power to Alcoa during each of the first two years of the contract, and 320 aMW during each of the final five years. The contract would contain cost caps that would allow BPA to incur costs of up to \$432 million over the seven years of the contract in order to serve Alcoa. Additionally, although we understand that Columbia Falls Aluminum Company (CFAC) has not yet accepted, BPA is offering CFAC a power sale that would result in BPA incurring up to another \$185 million over the same seven-year period. Based on the term sheets, we understand that the costs of the proposed power sales could be even higher, depending on the actual Industrial Power (IP) rate, and the market-price risks BPA would incur.

As explained in our numerous previous comments on this topic, PPC urges BPA not to enter into these types of arrangements, which will cause BPA to voluntarily incur significant losses in order to benefit the DSIs. These arrangements reflect an unfair and unjustified policy of forcing preference customers to shoulder higher power rates so that BPA can pay Alcoa or other DSIs to keep their plants operating. The PPC’s members will in turn be required to pass on those costs to homes and businesses during one of the worst recessions in memory. Even BPA’s analysis, which did not take into account the current economic recession, indicates that the proposal to serve the DSIs at the levels contemplated in the term sheets would cause the loss of more than 1,300 jobs among public power’s consumers.¹

¹ Summary of BPA’s Use of the Regional Economic Study to Contemplate the Service, available at http://www.bpa.gov/power/pl/regionaldialogue/implementation/documents/2009/2009-07-23_Summary_Regional_Economic_Study.pdf.

Furthermore, the term sheets are especially troubling because they demonstrate that BPA is now willing to assume significant and unreasonable risks in addition to the costs described above to advance its policy of helping the DSIs at public power's expense.

BPA Is Proposing to Assume Significant and Unreasonable Risks That It Has Previously Stated It Would Not Assume

At a June 8th workshop, BPA discussed ideas about service to the DSIs after FY 2009. At that workshop, the agency presented materials setting out BPA's objective of serving the DSIs while "limit[ing] BPA's financial exposure, thereby mitigating impacts on other power customers."² Prior proposals for serving the DSIs during this time period included liquidated damages and take-or-pay obligations that BPA insisted on to protect it (and its preference customers) from market price risk if the DSIs curtailed or ceased their use of BPA power.³ These provisions were calculated to make BPA financially indifferent at least to whether the DSIs continued operating.⁴

Under the term sheet, however, BPA now proposes to almost entirely remove the take-or-pay and liquidated damages provisions from the deal, allowing Alcoa and CFAC to leave BPA and its customers exposed to the cost risks of any power purchases made on the DSIs' behalf if they determine that closing their operations would be more profitable for the companies. If they did close their plants, the DSIs would be required to give only 12 months' notice, and then be allowed to terminate with no further cost—leaving BPA and its customers to deal with remaining stranded costs.⁵

BPA's new appetite for voluntarily assuming market risks runs counter to the agency's stated goals, and certainly its customers' sense of how BPA should be managing

² June 8th Power Point presentation, Slide 4, *available at* http://www.bpa.gov/power/pl/regionaldialogue/implementation/documents/2009/2009-06-08_DSI_workshop.pdf.

³ *Id.*, Slide 5.

⁴ *Id.*

⁵ BPA's assumption of the risks associated with serving CFAC seems especially unwise at this time. PPC notes that Glencore, the privately-held Swiss parent company that ultimately benefits from the CFAC plant's profits, has recently had major declines in its credit rating. *See* <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aCp9QvbtHJFc> (May 19, 2009 Article). Additionally, it is unclear what responsibility Glencore would have to compensate BPA for any defaults or breaches of a contract, given that CFAC appears to be owned 100% by a subsidiary of Glencore. <http://www.glencore.com/pages/aluminium.htm>.

its resources. Additionally, if BPA's goal is to increase regional employment, the proposal to allow Alcoa and CFAC to close their plants and walk away without paying BPA anything seems ill-tailored to even that goal.

We understand that BPA may believe that preference customers benefit by a trade-off through the term sheet's provision that if Alcoa terminates the contract it cannot come back to BPA for power during the remaining term (*i.e.*, until after 2016). PPC points out, however, that as currently contemplated, preference customers would have no contractual right to enforce this provision, and BPA would be free to seek to renegotiate another power sale or monetary benefit program with Alcoa even after termination.

In short, PPC perceives no rational basis for the agency to agree to take on significant market risk and adamantly opposes BPA's decision to do this for the benefit of the DSIs.

BPA Has Not Demonstrated Any Legitimate Business Case for Incurring Huge Losses to Serve the DSIs

BPA's Actions Must Be Supported by an Analysis of How They Further a Duty or Legitimate Interest of BPA

In its December 2007 opinion, the Ninth Circuit Court of Appeals found that BPA's 2006 Block Contracts with Alcoa and CFAC were unlawful because they compensated the companies based on a rate that was more favorable than the Industrial Power (IP) rate, and because BPA did not demonstrate that the deal was within the scope of BPA's legitimate business interests.⁶ Since that opinion, BPA has taken the position that so long as service to the DSIs is based on the IP rate, BPA is authorized to enter into any deal with them.

PPC disputes BPA's unreasonable interpretation of the relevant statutes and case law, and reiterates our belief that BPA is not authorized to sell power to the DSIs, even if based on the IP rate, if doing so is contrary to BPA's business interests. Unfortunately, it again appears that the agency is proposing to serve Alcoa at a significant loss to the agency without any demonstration of why this action is in BPA's interest.⁷ PPC believes that doing so will render the contract unlawful and invalid.

⁶ *Pacific Northwest Generating Cooperative v. BPA*, 550 F.3d 846, 873-74 (9th Cir. 2008).

⁷ Although PPC recognizes that the agency has released an updated economic study it believes shows a net regional employment benefit from its actions, BPA has not offered any reason why this net employment gain necessarily translates into a benefit for the agency or its customers. Furthermore, for the reasons described below, the study is not persuasive or based on relevant information that should be considered.

If BPA Has a Business Case That Supports the Construct, the Region Should Discuss It

PPC urges BPA to set out its justifications, if any, for the proposal outlined in the term sheets. These justifications should be made open for comment and good faith discussion.

Because preference customers are responsible for paying *all* of BPA's costs, they have a legitimate role in evaluating BPA's justifications for entering into what is known to be a significant money-losing transaction. BPA should not seek to support any contract with Alcoa or CFAC with after-the-fact justifications that are not subjected to good faith debate and credible analysis.

BPA Has Not Provided Any Credible Evidence That the Proposed Transaction Will Benefit BPA or the Region.

PPC has seen nothing so far to lead it to believe BPA can demonstrate a legitimate business interest in incurring losses like those set out in the term sheet. To date, the agency has only offered reasons that are either political in nature (*e.g.* in response to pressure from Alcoa or interested representatives) or speculative and without evidentiary or analytical support (*e.g.* speculation that the DSIs could assist BPA in the future as they did in the past when BPA had a large surplus of power and no market). The fact that BPA has not offered any reasonable business case for its actions leads PPC to believe there is none.

To the extent that BPA relies on its "updated" *Economic Analysis* to show that the region, even if not BPA, benefits from the deal through increased employment, PPC observes that the updated study is not persuasive, ignores express limitations in the original *Economic Analysis*, and is based on outdated data and assumptions. For example, BPA failed to update the study to take into account the severe economic downturn that began late last year. The study's assumptions, therefore, of how much preference customers' consumers can "bear" to pay in their power costs for the DSIs are almost completely without application now. Moreover, BPA seems unwilling to acknowledge the original study's express disclaimer about the purposes for which it should be used. The study states:

None of these studies [on which the report's economic impacts analysis is based] anticipate conditions that the industry will face in 2011, and none of them are based on a cost estimate of the profitability of these aluminum smelters in the year 2011. . . **The main point that we [(the authors)] would make is that these**

studies have relied on data that is not relevant to the current question at hand, or is only marginally relevant.⁸

BPA's reliance on this study to show that it is in the region's interests to keep the smelters operating through the proposed arrangement is therefore completely unsupported. That reliance may have been somewhat mitigated if BPA's "updating" of the study supplied meaningful data that would make the study "relevant" or at least more than "marginally relevant." However, the update did not do that. Rather, BPA only updated a jobs multiplier, and left untouched the outdated economic assumptions, aluminum market assumptions, etc.

Aside from the fact that BPA has, to date, failed to articulate a rational business case for what it proposes to do, BPA's recent actions regarding the DSIs lead PPC to believe that BPA has not developed any cost-benefit analysis of serving the DSIs, and that it has not developed a principled determination of the limits it would insist on in serving the DSIs. This belief is supported by the agency's apparent willingness to move toward whatever Alcoa advocates, without seeking offsetting consideration for BPA's concessions.

For example, after BPA determined it would continue to supply payments to the DSIs at essentially the same level as it did under the contracts invalidated by the Ninth Circuit, Alcoa developed and asserted a claim against BPA for over \$190 million in "damages," for *not being paid enough* under the invalidated agreements.⁹ Instead of changing its position on what it should give Alcoa in the future, BPA responded by pushing forward with its determination to supply Alcoa the benefits it received under the invalidated agreements.

Then, Alcoa urged BPA that it wanted a variable power rate, which would lower its rate and cost BPA even more money in the near-term. BPA responded by proposing a variable rate.¹⁰ Subsequently, Alcoa determined that what it really needed was more power, and that it could go without a variable rate if it got more power from BPA.¹¹ BPA responded by apparently agreeing to sell Alcoa and CFAC more power. Additionally, as

⁸ *Regional Employment and Economic Impact Study*, p. 6 (August 11, 2006) (emphasis in original).

⁹ See Opening Brief of Intervenor Alcoa, filed on April 20, 2009 in Case No. 09-70228, 09-70236 (claiming damages of over \$190 million for overpayments Alcoa was "forced" to make in the market).

¹⁰ See BPA staff proposal for a variable IP rate for the DSIs in BPA's WP-10 rate case, available at <https://secure.bpa.gov/RateCase/openfile.aspx?fileName=WP-10-E-BPA-45.pdf&contentType=application%2fpdf>.

¹¹ This information was the subject of discussion at the June 8th workshop.

described above, BPA has coupled its offer of more power with a concession that it, rather than Alcoa, will assume the market-price risk involved in the transaction. Finally, the term sheet shows that BPA has abandoned, likely at Alcoa's request, its insistence that Alcoa make capital investment commitments in the plant before it be allowed to purchase BPA power.¹²

Given BPA's willingness to back away from almost all of the items it has insisted on in the past, for no movement from the DSIs in return, preference customers doubt that BPA has a principled analysis of the terms it would insist on before agreeing to serve the DSIs.

Key Questions That Bear Directly on the Advisability of the Proposed Deal Remain Unanswered

In addition to the serious issues outlined above, several key questions about the deal remain unanswered. These questions should be further explored before BPA enters any long-term deal with Alcoa or CFAC that could impose significant costs on BPA and its customers. These questions include:

- 1) What evidence does BPA have that the costs it will incur for Alcoa and CFAC are tailored to the companies' ability to keep the plants open, rather than simply increasing the companies' profits over time?
- 2) Given Alcoa's representation that it has purchased power in the market at over \$60/MWh through 2011, what is Alcoa planning to do with that power?
- 3) Given that Alcoa has raised claims against BPA for over \$190 million, how would Alcoa's prevailing on any such claim change BPA's determination that the cost levels set out in the term sheet are appropriate?
- 4) Given that BPA has recently delayed its determination of the DSI "lookback" (*i.e.* its determination of whether Alcoa owes it money, or whether BPA somehow owes Alcoa money), how does BPA have enough information to make a determination that it should enter the proposed deal with Alcoa?
- 5) Given the announced closure of the CFAC plant and laying off of the CFAC employees, what is the benefit to BPA or the region of incurring losses to benefit CFAC or Glencore?

¹² This requirement had been reflected in earlier drafts of contracts to serve Alcoa, which were ultimately not signed by Alcoa.

- 6) What assurance do we have that Alcoa and/or CFAC are not simply absorbing as much benefit from BPA as possible before closing their regional plants within the next few years?

An additional question raised by the term sheet is whether BPA plans to conduct an Environmental Impact Study (EIS) in connection with the proposed sale to the DSIs. It appears that the agency's 1995 Business Plan EIS assumed in all alternatives analyzed that an increase in service to the DSIs would increase BPA's revenues.¹³ This is not the expected case under current circumstances, where the proposed sale to the DSIs is expected to cost BPA up to around a half of a billion dollars over 7 years. Additionally, the proposed sale of substantial amounts of federal power to the DSIs over a long-term period is inconsistent with the "market-driven alternative" selected by BPA after the 1995 EIS, which assumed decreasing levels of DSI service over time.

Conclusion

BPA's proposal to incur over a half of a billion dollars over the next seven years to serve Alcoa and CFAC, and to also remove the take-or-pay and liquidated damages provisions from the transaction, only strengthens PPC's opposition to the course of action contemplated by BPA. For all of the reasons described above, PPC urges the agency to not execute an agreement of the type outlined in the term sheets.

¹³ See, e.g. *Business Plan Final Environmental Impact Statement* (DOE/EIS-0183), S-16 through S-17 (describing the various scenarios for DSI service that were analyzed in the EIS and assuming, in all scenarios, that increased DSI service would increase BPA's revenues).