NRU

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Allen Burns, Acting Deputy Administrator
Bonneville Power Administration
P.O. Box 3621
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Dear Mr. Burns,

On December 22, 2008, on June 22, 2009, and again on July 30, 2009 Northwest Requirements Utilities (NRU) submitted extensive comments on a proposed power sales agreement between BPA and Alcoa, Inc. Our comments addressed the defects in the draft contract and term sheet. NRU is now presented with a new draft contract for a power sales contract between Alcoa and BPA. While we recognize that BPA has made some changes in the draft contract to attempt to address NRU's and others within public power's concerns, NRU sees nothing materially different to change our previous position. NRU continues to view any sale to the DSIs that imposes costs on public power customers as unacceptable.

General Comments

Since the draft contract was released in August, new developments significantly change the landscape against which the proposed DSI contract should be evaluated. Specifically, last week the Ninth Circuit ruled in the case of *Pacific Northwest Generating Cooperative, et al. v. BPA*, Case Nos. 09-70228, etc. (Aug. 28, 2009)(*PNGC II*). In that opinion, the Court ruled as follows:

> In sum, we hold that BPA's voluntary decision to contract with the DSIs, like its other non-obligatory contractual choices, must conform to the congressionally imposed requirement that the agency act in a manner "consistent with sound business principles." *See* 16 U.S.C. §§ 838g; 839e(a)(1); 825s. *The mere fact that BPA has chosen to contract with a DSI at the statutorily authorized IP rate does not insulate the decision to contract from review under the "sound business principles" standard.*

Id., Slip Opinion at 11975 (emphasis added).

What NRU urges the agency to take away from the Court's recent decision is the understanding that, when the agency enters into a *discretionary* contract, it is making a business decision that must be supported with sound business analysis. The Court's logic applies with equal force to the current proposed contract: if BPA enters into a discretionary arrangement with Alcoa, and the arrangement imposes costs on preference customers that are not completely offset with benefits to them, then the Agency's decision to sign the contract fails BPA's legal standard of maintaining "the lowest possible rates to consumers consistent with sound business principles." *Id.*, at p. 11985.

BPA's justifications for this proposed Alcoa arrangement will not stand up to judicial scrutiny. The Court has already, in the first and second *PNGC* decisions, rejected the view that "preserving jobs"

is an adequate rationale for a contract with Alcoa. Additionally, the Court has as much as ruled out the possibility that "preserving the DSIs for future operational benefits" would satisfy the legal obligation to establish rates that are as low as possible consistent with sound business principles:

> Moreover, the information that the administrative record does contain would lead a rational observer to conclude that Alcoa is not particularly likely to provide significant future benefits to the agency. **[…]** Given that the only information in the record shows that DSI load has been steadily declining for years and that the current health of the aluminum smelting industry is precarious at best, BPA could not reasonably have concluded that Alcoa will be healthy enough in the future to provide sufficient benefits to BPA to compensate for the tens of millions of dollars that the agency is now giving away.

Id., 11990. In sum, NRU strongly urges the Administrator not to enter into any contractual relationship with Alcoa that imposes higher costs on the agency's preference customers.

Comments on the Draft Contract

Regarding the draft contract, NRU has three specific comments. First, the structure of the proposed contract suffers from the same infirmity as the arrangement struck down by the 9th Circuit. It is just carried out differently. In its discussion of the arrangement the court sent back for remand the court said, "BPA agreed voluntarily to make a nearly $32 million cash "benefit" payment to the aluminum company, so that the company could purchase power from one of BPA's competitors. BPA's justifications for this unusual transaction, under which the agency received nothing directly in exchange for its $32 million, do not demonstrate that the transaction was 'consistent with sound business principles,' as required by BPA's governing statutes."

Under this new draft contract the DSIs will in fact purchase power under the IP rate. However, if it costs BPA more to serve the DSIs than the posted rate, because the price of power purchased to serve the DSIs is higher than BPA's posted rate, BPA will simply turn around and compel its other customers to pay for the difference (if those costs are below the cost cap).

How does this compare with how BPA collects costs for its public power customers? Consistent with sound business principles, BPA forecasts its costs for the rate period and sets rates based on those forecasts. If BPA forecasts that it needs to purchase additional power to meet load growth, those costs are added to the revenue requirement and paid for by the customers requesting this type of service. Slice and block customers that provide for their own load growth costs pay for those costs. The difference between actual costs and forecasts are dealt with through changes to financial reserve levels and CRACs for load following customers and block and through true-ups for Slice customers. This approach to cost recovery will become even more pronounced after 2011 when public power customers will face the cost of their own utility's load growth directly. By contrast, there is no ability for BPA to recover from the DSIs any differences between forecast and actual costs of serving them.

To tell one class of BPA customers that they will pay their own way with regard to cost recovery and then to tell another class of customers--the discretionary class--that they will have a large portion of the cost of their load service covered by that first class of customers is not only inconsistent with sound

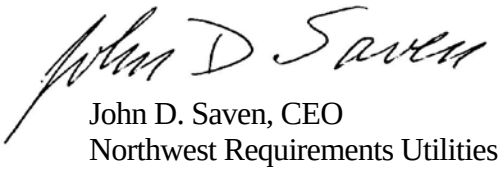
business principles, it is also inconsistent with the goals of the Tiered Rate Methodology. The TRM states: "*The cornerstone of the Regional Dialogue Policy is to limit BPA's sales of firm power at the lowest cost-based rates to approximately the firm capability of the existing Federal system. Customers may purchase additional Federal power, but it will be priced at a Tier 2 rate based on the marginal cost of serving the additional load.*" *BPA Long Term Regional Dialogue Final Policy, page 7.*

Second, the proposed "cost caps" in the contract do not guarantee preference customers that they will be protected from paying for the cost to BPA of serving Alcoa. The caps are based on forecast costs, not actual costs, and so there is nothing in this contract that limits BPA's and preference customers' actual exposure to higher costs of serving Alcoa. Because BPA cannot state what the actual costs of serving Alcoa will be, neither can BPA make a cost-benefit analysis of the transaction that would satisfy the "sound business principles" legal standard to which BPA is bound. If the cost cap was violated when BPA actually went out and bought the power with the rest of the customers' actual money, then the non-DSI customers would have to pay these costs as well.

Third, § 20.11 of the contract states that, even if the contract is declared unlawful or void by the Ninth Circuit, *BPA will nevertheless not seek damages or restitution from Alcoa*. In light of the two *PNGC* decisions, § 20.11 is particularly disheartening to preference customers. Agreeing *in advance* that BPA will not seek to recover sums unlawfully paid even if the contract is declared void or unlawful is tantamount to telling preference customers, and perhaps even the Ninth Circuit, that the Court's rulings will have no demonstrable bearing on the agency's decision-making. As discussed in more detail in the PPC's comments,[1] BPA is obligated by law to seek restitution when an agency action is declared void. BPA cannot agree in advance that it will not seek to rectify legal error that the Court may well determine it has committed.

In conclusion, NRU urges the agency to not enter into this new contract with Alcoa particularly in light of the recent Ninth Circuit ruling. BPA must demonstrate, with analysis that is clear and convincing, that any future service to the DSIs will pay for itself and will not require subsidies from preference customers. That test has not been met.

Very truly yours,



John D. Saven, CEO
Northwest Requirements Utilities

CC: Members of NRU
Scott Corwin, PPC
John Prescott, PNGC

[1] NRU supports the comments filed concurrently by the Public Power Council.