

November 10, 2008

Steve Wright, Administrator
Bonneville Power Administration
PO Box 3621
Portland, OR 97208

Re: Northwest Requirements Utilities' Comments on the Memorandum of Understanding between Bonneville Power Administration and Alcoa

Dear Mr. Wright,

Thank you for the opportunity to comment in writing and for conducting a public meeting allowing interested regional stakeholders to provide input regarding the Memorandum of Understanding between Bonneville Power Administration and Alcoa. In addition, BPA has explained that it intends to offer an MOU to Columbia Falls Aluminum Company (CFAC) under the same general terms.

Northwest Requirements Utilities ("NRU") is providing the following comments as a trade association that represents the interests of 55 load following customers of the Bonneville Power Administration located in 7 states, and representing about 25% of BPA's public power loads. While these comments have been reviewed by the membership, and generally reflect their views, we are encouraging all members to express their views to BPA, particularly if they have a different opinion from the recommendations contained in this letter.

Load following customers in most cases rely exclusively upon BPA for both power supply and transmission services and pay for these services through BPA's power and transmission rates. Therefore any action BPA takes to increase or decrease costs will affect the cost of our entire power supply resource.

This proposed MOU would increase the rates to be charged NRU's membership over the new contract period beginning FY 2012 by up to \$93 million per year. BPA has made other key decisions that will also increase the overall cost of our future power supply, such as the MOAs with Tribes and States regarding FCRPS operations, and expected future benefits for residential and small customers of Investor Owned Utilities. The retail customers of the NRU membership count on a cost based power supply from the Agency as a key component to their economic survival, particularly those businesses engaged in national and international competition where power supply is an important component of the underlying costs of doing business.

In light of the rate pressures our customers are facing, and given the DSI's lack of statutory authorization for continued power supply at a subsidized rate, we oppose the MOU BPA is considering to offer Alcoa, and likely CFAC.

During the public meeting Alcoa representatives identified three rationales for power supply service post 2011. In this letter, we will address those three points, as we did in the meeting, and then offer additional recommendations regarding the proposal.

1. Statutory Authorization for Service to the DSIs

Clearly we disagree with Alcoa on this point. We believe BPA's statutory authorization to provide power supply to the DSIs expired in 2001 at the end of the original 20 year contract. The situation post 2011 is further exacerbated by the fact that BPA on a forecast basis simply doesn't have sufficient power supply as part of the FCRPS to serve this discretionary load after forecast public power loads have been met. BPA would have to make augmentation purchases to serve DSI loads. The current benefits DSIs receive are financial only. While NRU has not previously participated directly as a party in any of the regional litigation regarding DSI service, the possibility of litigation would need to be re-examined by the NRU Board, and in conjunction with other public power utilities and associations if BPA proceeds with a MOU that we do not support.

2. The Jobs and Regional Economic Impact Issue

Alcoa makes arguments about jobs and BPA seems to focus much of the discussion on whether the DSIs have a positive economic impact on the region as a whole. The cost of the Alcoa MOU could average \$65 million per year. In turn Alcoa commits to keep 480 jobs at the Intalco plant. That works out to a potential subsidy of \$145,000 per job! This arrangement would continue for the period 2012 to 2028. This isn't a proposal to subsidize a limited portion, say 10% to 20% of an employee's wages, to keep a large number of jobs in the region, but rather a very high subsidy per employee involved in jobs that are extremely energy intensive.

Under this proposal the members of NRU will pay rates that are higher than they would otherwise be in order to subsidize the continued operation of Alcoa. This is in spite of the fact that BPA's public power customers themselves have industrial customers that are struggling economically and are or may be going out of business in the near future. It is nonsensical for public power customers, who are themselves struggling in tough economic times, to subsidize the DSIs who are purported to also be struggling financially.

We respect the concerns of the Intalco employees for continued employment. However, during the public meeting we also heard from other industrial customers, such as Weyerhaeuser, that have endured significant reductions in force, that face international competition, that use electricity as a significant element of their production cost, and have no ability to pass along to their customers further rate increases to subsidize the DSIs.

BPA notes in its press release: "An independent economic analysis performed for the Northwest Power and Conservation Council in 2006 suggests the plant's survival would produce a small but positive net employment impact for the region." However the press release neglected to mention the major finding of that study: "Should the plants close, in the long-term, given the resiliency of the regional economy there is no significant drop in regional employment and income." While parties can quibble about regional economic studies, we believe the results simply are not

compelling. Unfortunately, the economic engine of this country is experiencing a very difficult time. We see it in both a decline in business activity and the ability of residential customers to pay their bills. The DSIs, and particularly the multi-national company Alcoa, should not be carved out for special treatment at the expense of public power and their industrial customers.

3. The DSIs Have Been Long Term Customers of BPA

We understand the argument from Alcoa that they have been in the region for a long period of time and have contractually relied upon BPA for power supply or financial benefits. That argument leads NRU staff to a conclusion that the MOU for Alcoa needs to be reviewed at a policy and cost level to see if it has merit for the post 2011 period.

BPA claims to find a middle ground between those who believe that BPA no longer has the authority to provide power to the DSIs and those that believe that Alcoa should be treated “as any other long term customer.” The DSIs are not currently buying power from BPA; instead they are being given financial benefits paid for by BPA’s other customers. Thus, the DSI load (if delivered as power rather than financial benefits) that BPA will be serving under this MOU in 2012 will be new load on BPA. Under BPA’s Tiered Rate Methodology (TRM), also beginning in FY 2012, public power customers will face and pay marginal prices for their individual load growth under the new Contract High Water Mark contracts. In direct contrast, however, this additional DSI load placed on BPA in FY 2012 will **not** face marginal pricing, but will in fact be subsidized by the very customers that are themselves paying full market prices for their additional load.

If the DSIs were to be treated “as any other long term customer,” Alcoa’s additional load in FY 2012 would be served at market prices. Instead, BPA is proposing to have the rest of its customers pay for the difference between the cost of purchasing this power and the amount the DSIs are paying for this power. This strikes at the heart of the TRM. Why should existing BPA customers subsidize the DSIs in order to provide them with cost based power for these new loads, while existing customers will face the market price of power for load growth?

A related problem here is that if BPA agrees to the MOUs with Alcoa and CFAC, the Agency could be in the market for up to 350 aMW of power. The publics contractually don’t need to declare their amounts of above High Water Mark loads for FY 2012 until November of 2009. This puts BPA Tier 2 customers at a possible disadvantage if BPA goes out to find power products for them shortly after the Agency has had to procure 350 aMW for the DSIs. We are concerned that market forces could drive up the cost of Tier 2 if it follows on the heels of an augmentation purchase for the DSIs.

DSIs are Currently Receiving Financial Benefits Only

As noted above, the DSIs are not taking power deliveries from BPA at this time, but rather are receiving financial benefits. We understand that up to \$55 million per year for DSI support is included in BPA’s current rates, and Alcoa is drawing about \$39 million. If in spite of the objections from public power, BPA proceeds with a post 2011 MOU for Alcoa and CFAC, we believe BPA should only offer financial benefits, particularly if power deliveries involve augmentation purchases. However, the price parameters of the current MOU offering at a potential cost over the term of the agreement of \$93 million per year are too generous. While it is true that the actual cost will be based on a combination of market prices and the IP rate that BPA established for the post 2011 period, the

fact that BPA projects an IP rate of \$38 MWh should signal the region as to the general likely outcome of the rate case. It's fair to assert not only that the deal will be expensive, but that Alcoa will have relative certainty now about the degree of financial risk they are facing for power delivery of up to 240 aMW of power from BPA.

In stark contrast to the Alcoa proposal, the publics that are seeking service from BPA for their above High Water Marks have no such "safe harbor" of relative price certainty, and will only know that 1) Tier 2 rates will not be subsidized, 2) Tier 2 rates are subject to the volatility of future market conditions, and 3) BPA is currently not offering bi-lateral deals to the publics that may otherwise be willing to lock up a Tier 2 resource now at a known or formula adjusted rate. This puts public power at a disadvantage for Tier 2 power service compared to the potential power deliveries to Alcoa.

An NRU Perspective Regarding What BPA Should Do

Within the NRU membership, we are not aware of individual utilities that support continuing service to the DSIs post 2011, particularly when such service creates upward pressure on rates. While we have not been a party to the negotiations, if BPA decides to offer a package to the DSIs, then it should be financial benefits only. BPA should not buy power for DSIs, particularly when the publics are waiting for the complete range Tier 2 service options and prices. Rather than making assumptions about market prices and an IP rate, BPA should establish an amount of financial benefits, similar to current practice. The amount of financial benefits for the FY 2012 – 2016 period should not exceed in nominal terms the benefits BPA's other customers are currently providing through the current rate structure. If either Alcoa or CFAC reject such an offer, their prorated share should not be shifted to the other company. This capped amount of \$55 million in current rates, rather than potentially \$93 million, would be more realistic. It is important to note that \$55 million is well above the \$39 million Alcoa is currently receiving and CFAC is not receiving benefits at this time. A \$55 million cap would reduce the impact on public power customers in the Tier 1 rates to about 3%. Also, the subsidy per job would fall from \$145,000 to \$87,500 per job, still an extremely high number, but one that may be more within the limits of reasonable discussion regarding the use of public money.

Recommended Revisions to MOU if Power Deliveries are Offered

If BPA continues discussing power deliveries to the DSIs, then the following points should be added to any agreement:

1. This sale should impose no further capacity constraints on the BPA system. The system is already capacity constrained. Also, we must ensure that the transmission system is not further constrained by this transaction. Any costs of relieving congestion to accommodate this purchase must be recovered from Intalco.
2. If this power is not purchased as a flat block, any costs associated with transforming the power into a flat block must be recovered from Intalco. This cost must be included in the calculation of the acquisition cost of the power for the price cap test.
3. The power re-allocation provision in section XII should be rejected.
4. In Section XIV the MOU is not specific as to the capital investments that are required at Intalco (or even whether these investments must be made at this specific plant). This

needs to be clarified. These investments should be made with an eye to increasing the efficiency of aluminum production.

5. Section IX (liquidated damages) needs a thorough review. Under this proposed MOU in the event that liquidated damages from plant termination or default are negative (the market price exceeds the purchase price) Intalco gets to keep the money. This is at odds with how BPA's public power customers are treated and should be removed.
6. There must be an explicit provision in this agreement against Intalco's re-sale of this power into the market.
7. Steps must be taken to mitigate the long term costs of any future carbon taxes or other carbon footprint mitigation measures that may be needed as a result of any purchase to serve Intalco. Any future costs associated with carbon mitigation will need to be recovered from Intalco.
8. Publicly owned utility customers of BPA should be given first right of refusal to request that any resource be included in a Tier 2 cost pool prior to this power being offered to the DSIs.

Please note that these suggested revisions do not represent concurrence at a policy level to what BPA is proposing, and if BPA adopts some or all of these revisions, such action would not be a waiver by NRU of our ability to legally challenge the DSI contracts.

Sincerely,



John Saven, CEO

CC: Members of NRU
Paul Norman, Senior Vice President, Power Services
Scott Corwin, Executive Director, Public Power Council
Jack Speer, Alcoa Consultant