Bonneville Power Administration's Service to Direct Service Industrial (DSI) Customers for Fiscal Years 2007-2011

Administrator's Record of Decision

June 30, 2005

BONNEVILLE POWER ADMINISTRATION'S SERVICE TO DIRECT SERVICE INDUSTRIAL (DSI) CUSTOMERS FOR FISCAL YEARS 2007-2011

ADMINISTRATOR'S RECORD OF DECISION

Bonneville Power Administration
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I. Scope of DSI Service within Regional Dialogue

Beginning in July 2004, the Bonneville Power Administration (BPA) initiated the Regional Dialogue process as part of its effort, in cooperation with its customers and constituents, to identify and decide issues regarding BPA's power supply role for FY 2007-2011. *See, Bonneville Power Administration's Policy Proposal for Power Supply Role for Fiscal Years 2007-2011* issued July 7, 2004. BPA service to Direct Service Industries (DSIs) has been steadily declining since the pre-1995 period when contracts totaled over 3,000 aMW, to 1995 when contracts were reduced to 2,000 average megawatts (aMW), to 2002 when contracts were reduced to 1,500 aMW (with much less actually delivered in the 2002-2006 period). Over the same period, BPA service to public utilities has grown significantly. Among the issues presented by BPA was whether it should continue the steady ramp-down of service to its DSI customers when existing power supply contracts with those customers expire on Sept. 30, 2006, or whether to eliminate further service. BPA proposed providing up to 500 aMW of service (cumulative) to creditworthy DSIs, at a known and capped cost, where such service would enable continued operation of DSI facilities, thereby maintaining Pacific Northwest jobs.

BPA indicated that, in order to eliminate the market and default risks to BPA associated with a traditional "take-or-pay" physical power sales contract, and to meet the known and capped cost prerequisite for DSI service, its preferred alternative was to provide service benefits to the DSIs financially, by cashing-out, or monetizing, the value of a power sales contract in lieu of physically delivering power. BPA indicated also that it believed it was unlikely that service to the DSIs under the Industrial Firm Power (IP) rate schedule would provide a rate low enough to support economic operation by DSI customers that use BPA power to smelt aluminum. The aluminum smelters would make up over 95 percent of BPA's DSI load under a 500 aMW scenario. The proposal to provide 500 aMW of service benefits to the DSIs represented a continuation in the ramping-down of BPA's role as a supplier of power service to the DSIs.

II. First Phase Regional Dialogue – Administrator's Record of Decision (February 4, 2005)

The culmination of the first phase of the Regional Dialogue process was the *Policy For Power Supply Role For Fiscal Years 2007-2011- Administrator's Record of Decision (*February 4, 2005). In it, BPA decided that for the 2007-2011 period it would continue the ramp-down in DSI service by providing eligible DSI customers some level of service benefits, at a known quantity and capped cost, at rates no lower than rates paid by BPA's public preference customers, and under contractual terms no better than those offered to other customers. That decision is not being revisited in this record of decision. However, in order to provide an opportunity for additional dialogue with (and among) customers, in the hope of achieving any possible consensus for a balanced and durable solution for BPA service to the DSIs, BPA reserved for later decision: (1) the actual level of service benefits it would provide, (2) the eligibility criteria it would apply in determining which DSIs would qualify for such service benefits, and (3) the mechanism or mechanisms it would use to deliver those service benefits. BPA's resolution of these issues is addressed in this record of decision.

III. Report to the Region

On February 4, 2005, BPA sent a letter to customers and constituents describing a public process for additional comment on these reserved DSI service issues, and outlining its straw proposal on each issue. The public process called for a March 1, 2005, open forum hosted by the BPA administrator and an opportunity to file additional written comments by March 11, 2005. BPA suggested a straw proposal that provided up to 500 aMW of service benefits to the DSIs at a capped cost of $40 million a year. BPA noted that this amount of benefits was in line with the level of support many non-DSI customers had indicated in previous comments they were willing to support, and that the proposal struck a reasonable balance between supporting DSI operations and attendant jobs and the need for BPA to contain costs.

With respect to the mechanism to deliver these service benefits, BPA's straw proposal was to provide financial benefits in lieu of a physical power sale. Under this mechanism, BPA would monetize, or convert to cash, the financial value of a physical power sales contract. BPA's straw proposal contemplated a three-way surplus power sales contract between BPA, the DSI and the local public utility in whose service territory the DSI facility is located. The surplus sale, priced as close as possible to the rate charged by BPA to its public preference customers, would be made to the local utility, with the benefits passed on to the DSI customer. BPA stated in the letter that monetizing the power sales transaction enabled it reliably to meet the prerequisite that the cost of serving the DSIs be capped, but that BPA was willing to consider other mechanisms that could possibly also meet this criteria.

Finally, with respect to eligibility criteria, BPA's straw proposal centered on each DSI's creditworthiness, including evidence of each company's ability to operate and create employment during periods of challenging industry and company economics, such as during the current rate period, which has seen high power prices and sustained periods of low aluminum prices. The straw proposal noted that BPA wanted to focus the limited service benefits likely to be available where they had the greatest probability of promoting sustained DSI operations and associated job creation and retention.

BPA received almost 100 written comments from a broad cross-section of customers and constituents, including each of the DSIs, public customer organizations and many individual public utility customers, and individual citizens, including DSI employees and individuals from communities where the DSI facilities are located. In addition, the open forum, which was structured into five separate panel discussions, with questions from the audience, plus a public comment session, was attended by approximately 100 individuals representing the same broad cross-section of customers and constituents described above. Written comments regarding DSI service received in response to both the July 7, 2004, policy proposal, and the February 4, 2005, straw proposal are considered herein, as well as comments from the open forum, which are also highlighted and evaluated in this record of decision.

VI. Issue 1 - Level of Benefits

Parties' Comments

The issue regarding the level of benefits has two distinct but linked components: (1) the amount of service benefits to be provided, either through the delivery of power to the DSIs or through financial benefits (monetization) in lieu of power deliveries; and (2) the maximum cost, including market and credit risk, BPA will incur on behalf of the DSIs to provide such service

benefits. In its July 7, 2004, policy proposal, BPA indicated it was committed to exploring DSI service options that would continue the ramp-down in DSI service benefits to 500 aMW, at a known and capped cost. This proposed level of service was in line with amounts contained in the Northwest Power Planning Council's December 2002 recommendations regarding BPA service to the DSIs in the next rate period, and is in keeping with the long-term ramping-down of BPA service to the DSIs that began when access to the wholesale power markets became available to the companies beginning in the mid-1990s. Since then, BPA's DSI load has dropped by half from historical levels in excess of 3,000 aMW, to approximately 1,500 aMW. While the July 2004 policy proposal itself did not propose a specific cost cap, during the course of meetings and discussions with customers and constituents regarding the policy proposal, BPA indicated it believed the cost of DSI service to BPA and its other customers should be capped at approximately $40 million per year.

Comments On July 2004 Proposal

In response, each DSI commented on the level of service it would like to receive, but generally did not state what each thought other DSIs should receive. While not addressing the cost cap issue directly, each DSI stated or implied that the cost of such service to BPA must necessarily equal the delta, however much that may be, between BPA's lowest-cost rate under the Priority Firm (PF) rate schedule available to BPA's public preference customers (a rate level the DSIs generally argue is necessary to accommodate economic aluminum smelter operations) and the higher-priced market. Alcoa (Alcoa, RD04-0067) stated that prior discussions on limiting service to 100 aMW per smelter would not be sufficient for its Intalco smelter, located in Ferndale, Wash., to operate economically, neither enabling operations nor maintaining jobs. Alcoa asked BPA to provide it 438 aMW, and argued that the 500 aMW amount proposed by BPA is arbitrary. Whatcom County Executive's Office (Whatcom County, RD04-0008), and several Alcoa workers (Flaherty, RD04-0019, Rousseau, RD04-0019 and others) noted their support for 438 aMW to Alcoa. Columbia Falls Aluminum Company (CFAC, RD04-0111), CFAC workers (Keith Haverfield, RD04-0120, Steve Knight, RD04-0076 and others), and the city of Columbia Falls (city of Columbia Falls, RD04-0097) requested 170 aMW to cover half of CFAC's total capacity. CFAC indicated it believed if it could operate at approximately 50 percent capacity "during the tough times" then it could maintain the core of its workforce, suppliers, and other infrastructure elements in anticipation of better market prices for power, aluminum, and alumina. The Montana State Workforce Investment Board (RD04-0063) urged BPA to enable CFAC to "buy power from BPA at a cost-based rate." The CFAC smelter is located in Columbia Falls, Montana.

Evergreen Aluminum (Evergreen, RD04-0075) which was recently acquired by Glencore, and had a contract for only 6 aMW during the 2001-2006 period, requested 120 aMW, enough power to operate its Vancouver, Washington, smelter at approximately 50 percent capacity, thereby maintaining core operations in anticipation of improving market prices. Golden Northwest Aluminum (GNA, RD04-0101) endorsed BPA providing continued service to DSIs after the current contracts expire at the amount of 100 aMW per smelter. This approach would result in 200 aMW of power for GNA, 100 aMW for each of its two smelters, located in Goldendale, Wash., and The Dalles, Ore. Port Townsend Paper (Port Townsend, RD04-0045) asked for continued service for the "smaller than 20 aMW load" at its Port Townsend, Washington, mill at rates comparable to the rates its competitors can purchase BPA power from their local public utility district. The Public Power Council (PPC, RD04-0109) pointed out that

providing 500 aMW was not going to satisfy the DSIs since their stated needs exceed that 500 aMW amount. This comment was borne out by individual DSI requests, which totaled approximately 950 aMW. Aluminum worker comments requested "more than 500" in one instance, and in a couple of cases requests were made for 800-900 aMW (KBAlloys, RD04-0026 and McKinney, RD04-0028).

In other comments, the Industrial Customers of Northwest Utilities (ICNU, RD04-0093), the State of Washington Department of Community, Trade and Economic Development (Washington, RD04-0072), and several workers and citizens (Pike, RD04-0076, Stahlberg, RD04-0076, and others) specifically endorsed the 500 aMW limit. The Northwest Energy Coalition (NWEC, RD04-0110) indicated it would support service to 500-700 aMW of DSI load at some price below market, but asked that BPA consider the costs and benefits of such support relative to BPA's budget proposed for renewables. In addition to specific average megawatt limits, the four state utility commissions and the Eugene Water and Electric Board (EWEB, RD04-0127) expressed support for the principle that benefits be limited and fixed so that the cost to other customers be known and capped. EWEB also reiterated the importance it placed on 500 aMW and a cost of $40 million as absolute limits for DSI service. However, EWEB proposed that BPA serve the DSIs, at a rate discounted to market prices and costs capped at $40 million, only with surplus power from the federal system, and that it not make any augmentation purchases to serve the DSI load. Therefore, under EWEB's proposal any costs incurred would be limited to foregone surplus sales revenues, up to $40 million per year. Western Montana Generation & Transmission (WMG&T, RD04-0076 and RD04-0092) and Lincoln Electric Cooperative (Lincoln, RD04-0100) argued that BPA's proposal needed to be scaled back to 300 aMW. Public Utility District No. 1 of Ferry County (Ferry, RD04-0037) took the position that if BPA was going to acquire any resources to serve DSI load, it should charge the DSIs market prices for the power, so that other customers incur no costs associated with such service. Northwest Requirements Utilities (NRU, RD04-0073), the Western Public Agencies Group (WPAG, RD04-0105), Mason County PUD No.3 (Mason, RD04-0151), and Pacific Northwest Generating Cooperative (PNGC, RD04-0114) similarly expressed qualified support only for no-cost service alternatives.

In its February 4, 2005, straw proposal, BPA continued to propose that it provide up to 500 aMW of service benefits to the DSIs. In addition, BPA expressly proposed to cap the cost of DSI service at $40 million a year. This amount represented a benefit of approximately $10 per megawatt hour (MWh) on a 500 aMW allocation (representing the delta between a rough estimation of BPA's lowest-cost rate in the next rate period, and a snap-shot projection of potential forward market prices during the same period). BPA stated that this amount of benefits was in line with the level of support many non-DSI customers indicated in comments that they were willing to accept, and that it struck a reasonable balance between supporting DSI operations and jobs with BPA's need to contain costs.

Comments on February 2005 Proposal

In response to its straw proposal, BPA received comments and proposals covering a wide range of benefit levels. The DSIs, DSI employees, members of the communities in which DSIs facilities are located, and elected officials representing these areas, argued for a benefit level at least equal to, and in many cases greater than, the levels in BPA's straw proposal. The major organizations representing BPA's public preference customers, as well as individual public preference customers, were generally (though by no means enthusiastically) supportive of BPA's

proposal of up to 500 aMW at a capped cost of $40 million per year, but their support came with conditions attached. The principal condition was that benefits up to these levels be provided only if BPA's lowest-cost public preference rate for the next rate period does not otherwise exceed $27 per MWh (Clark, DSI-069, NRU, DSI-067, PNGC, DSI-088, PPC, DSI-079, Snohomish, DSI-075, Springfield, DSI-076, WREC, DSI-068, Western Montana G&T, DSI-092, WPAG, DSI-090). In addition, many parties made clear they would oppose any amount above the proposed $40 million cap.

Alcoa (DSI-077 and DSI-057) continued to propose that it be provided an amount of physical power equal to its current contract amount (438 aMW). Alcoa commented that it desires to operate its plants continuously and at full capacity, thereby producing aluminum at the lowest possible cost and providing maximum employment and financial benefits to the region. Alcoa indicated that allocating it 438 aMW of power at BPA's lowest-cost rate now would provide a "bridge" while regional long-term service issues are resolved.

Nevertheless, Alcoa indicated it would likely sign a new contract if BPA offered it less than 438 aMW at its lowest cost-based rate, provided contract terms are satisfactory and rates are in a competitive range, and that it would try to operate up to the limitations of that contract amount. However, Alcoa clearly stated the $40 million cap in the straw proposal "was not a viable service option." Using an example assuming a BPA rate of $27 per MWh and a market rate of $45 per MWh, and allocating all 500 aMW to itself, Alcoa concluded that the $40 million cap would allow it to buy down its effective rate by only $9.10 per MWh, to $35.90 per MWh. It asserts this rate level "would almost certainly make the Intalco plant non-competitive, whereas, it is much more likely to be competitive at the assumed [$27 per MWh] average rate." A number of Washington State legislators commented supporting Alcoa's proposal, echoing its argument that BPA's capped straw proposal is wholly inadequate and "puts at risk hundreds of family wage jobs." (Sen. Finkbeiner, DSI-049; *see also*, Reps. Morris and Chopp, DSI-051; Rep. Chandler, *et al.*, DSI-081; Rep. Linville, DSI-082; Sen. Brandland, DSI-050). Numerous Alcoa employees (Dennis Van Beek, DSI-008, L. Engler, DSI-006, and others) submitted comments supporting Alcoa's request for BPA to provide physical power equal to Alcoa's current contract amount, pointing to the direct and indirect jobs that would be provided, the support Alcoa provides the community, and that as a Federal agency BPA should be required to support family wage jobs. Businesses located in the community where Alcoa's Intalco plant is located (Diehl Ford Inc, DSI-028, Peoples Bank, DSI-029, and others), educational and environmental associations (Bellingham Technical College, DSI-013, Nooksack Salmon Enhancement Association, DSI-014, and others) and the mayor of Ferndale, Washington, (City of Ferndale, DSI-016) commented expressing support for Alcoa's proposal. Public Utility District No. 1 of Whatcom County (Whatcom, DSI-071), in whose service territory Alcoa's Intalco smelter is located, stated it supports a service benefit capped at between $40 to $60 million per year, so long as BPA's public preference rate "meets an acceptable target."

Columbia Falls Aluminum (CFAC, DSI-093) proposed a two-part (physical and financial) service benefit totaling 517 aMW. Under the CFAC proposal, 323 aMW of power would be allocated among DSIs that currently have contracts with BPA, each to receive a physical delivery of the lesser of 100 aMW or its current contract amount. *Id.* The balance (194 aMW) would be allocated evenly among CFAC, Alcoa, and GNA, and the value of the allocation monetized (converting the value of the contract to cash based on the difference between the contract price and market prices) up to a limit of $10 per MWh. CFAC's parent, Glencore Ltd., (Glencore, DSI-

085) stated that BPA's stated preference in the straw proposal to monetize a 500 aMW allocation up to a capped amount of $40 million per year "will fail to maintain jobs in the Northwest" given likely market power prices in the next rate period. Glencore stated if BPA adopts a financial transaction capped at $40 million it foresees a "strong likelihood that we will be given no other choice but to shut down" the CFAC smelter.

GNA (DSI-011) commented that it believes BPA should offer to serve the net requirements needed to support full operation of DSI customers, or at least offer to extend service at the current contract amounts through FY 2011. But citing "political realities" and BPA's stated preference to cap the costs of DSI service benefits using a financial transaction, GNA stated it "can accept a properly structured proposal for BPA to provide service benefits equivalent to 500 aMW of power at BPA's average cost." However, GNA argues that BPA should offer 500 aMW of physical power at its lowest-cost rate, or offer financial support that "is truly equivalent" to 500 aMW of power, and therefore not adopt the $40 million cap, since presumably it believes that amount of money is inadequate to do either. GNA stated it needed a minimum of 200 aMW in total to operate one potline each at its Goldendale and Dalles smelters. In additional comments (DSI-083) GNA stated 200 aMW would allow it to maintain "pilot light" operations at each smelter and position it to increase production by leveraging the BPA service when market conditions allow. The United Steel Workers Association Local 8147 (DSI-048), Northwest Energy Coalition (DSI-057), Klickitat PUD (DSI-058), and several GNA employees, steelworkers union representatives Jim Woodward (DSI –057), Gaylan Prescott (DSI-057), and others' comments were supportive of BPA providing 100 aMW per smelter. Gil Hayes (DSI-057), said that BPA needed to re-energize Northwest jobs and Northwest communities, and that BPA should provide 100 aMW per smelter with 20 percent transferable to a company's other smelters. Klickitat PUD (DSI-058), in whose service territory GNA's Goldendale smelter is located, noted that Klickitat County is "in a deep economic recession and needs all the help it can get" to retain the family-wage jobs the smelter provides.

Northwest Requirements Utilities (NRU, DSI-067) proposed BPA provide the DSIs a two-part 500 aMW service benefit comprised entirely of physical power, but only if a $27 per MWh average Priority Firm (PF) rate target is met. NRU proposed that each DSI be provided, presumably under BPA's market-based surplus power rate schedule, an amount of physical power equal to each company's actual purchases during the current rate period, up to 300 aMW in total, thereby maintaining the number of employees at the current levels. In addition, NRU proposes BPA offer an additional 200 aMW of service benefits to DSIs that meet certain qualifying criteria, but irrespective of the amount of power they purchased from BPA during the current rate period. Under the NRU proposal, the cost of service to the DSIs is not capped by the $40 million amount, but rather by its proposed $27 per MWh PF rate cap on a capped 500 aMW amount, with an additional separate cap on the 200 aMW equal to a $10 per MWh differential between the PF rate and market prices. Under its proposal, NRU noted that DSI benefits could exceed $40 million per year on a 500 aMW allocation so long as the $27 per MWh rate cap is not exceeded. Wells Rural Electric Company (Wells, DSI-068) also commented separately supporting NRU's proposal. Snohomish County PUD No. 1, (Snohomish, DSI-075) likewise commented that BPA should not make any firm commitments on expense items until it is assured that it will achieve the rate goal of $27 per MWh, which will not be known until the completion of the rate case. Port Townsend Paper (Port Townsend, DSI-045) commented that it believed it could support the NRU proposal and also noted that it provided 10-times more jobs per megawatt of purchased power than the aluminum smelter DSIs.

The Public Power Council (PPC, DSI-079) also proposed that DSI benefits be capped by the $27 per MWh PF rate target, but also by the $40 million cap, so that DSI benefits could not exceed $40 million even if additional benefits could be provided without breaching the $27 per MWh threshold. PPC stated that a cap is important in order to limit "BPA's (and BPA's customers') liability in the event of another energy crisis." However, PPC also argues that the level of the DSI benefit should fluctuate with any increases in the rate that BPA charges other customers, so that in some cases the annual benefit may be less than $40 million. PPC believes this criteria would provide DSIs with incentive to remain engaged in BPA cost and rate control. Clark County PUD (DSI-069) and Snohomish (DSI-075) commented generally supporting the PPC's proposal with respect to benefit level. On the other hand, NRU's proposal (DSI-067) stated that once a contract containing benefits levels is offered to the DSI, that it should not be adjusted, regardless of subsequent potential changes in BPA's financial position during the rate period.

The Western Public Agencies Group (WPAG, DSI-090) argued that it was "premature to even discuss the prospect of adding costs to BPA's preference customer rate" to serve DSI load when it is not clear BPA will meet its customers' $27 per MWh PF rate target, and that it was skeptical BPA could hold the line on its proposed DSI benefits level. However, WPAG proposed that if BPA was going to serve DSI load, the cost should be capped at a maximum of $40 million per year. The Pacific Northwest Generating Cooperative (PNGC, DSI-088), in addition to echoing other public customers' comment that any DSI service not cause BPA's PF rate for the next rate period to exceed $27 per MWh, also commented that under no circumstances should the cost cap exceed $40 million per year. Springfield Utility Board (SUB, DSI-076) agreed with BPA's straw proposal that service benefits should be based on 500 aMW and capped at $40 million per year, as did Washington State Senators Brown and Poulson (DSI-086). The Washington Department of Community, Trade and Economic Development urged BPA to establish a cap that reflects a balance between costs to other customers and the number of DSI jobs that will be protected (DSI-072).

Cowlitz County PUD (Cowlitz, DSI-070) and the Industrial Customers of Northwest Utilities (ICNU, DSI-084) indicated that the cost of DSI service benefits must be capped at a level that impacts BPA's public preference rate by $0.50 per MWh or less. Northern Wasco PUD (Northern Wasco, DSI-074), in whose service territory GNA's The Dalles smelter is located, indicated that an impact of $1.00 per MWh or less is reasonable. Western Montana Electric Generating and Transmission Cooperative (WMG&T, DSI-092) supports the $40 million cap, and commented that proposals that provide 900 aMW, or that are otherwise cost exorbitant, are unacceptable, but that conversely the "proposal must work for the DSIs or it is not worth pursuing." At the March forum, the representative from the Northwest Power and Conservation Council (DSI-057) took the position that benefits should be capped at $10 per MWh. Portland General Electric (DSI-057) commented at the forum that benefit levels should be set at a level so that other customers are not harmed, but that are sufficient to encourage job creation. Clatskanie People's Utility District (Clatskanie, DSI-087) proposed that benefit levels should be limited through serving the DSIs only with any surplus available from BPA's system, at a rate equivalent to BPA lowest-cost preference rate. Clatskanie notes that benefit levels would likely thereby be limited to power deliveries for only 3 to 4 months a year, with the possibility of zero benefits in some years. Central Lincoln PUD (DSI-066) suggested that BPA should limit the amount of benefits, within the $40 million cap, based on an analysis of "what it takes" for each DSI to stay open and operating.

There were several comments that were not supportive of BPA providing service benefits to the DSIs and that asked BPA to reconsider its earlier decision to offer some amount of service to the DSIs (ICNU, DSI-084; WPAG, DSI-090; Springfield, DSI-076; Benton, DSI-012; PNGC, DSI-057; *et al.*). Benton REA (DSI-012) believes BPA should not provide the DSIs any Federal benefits, and that benefits provided in the past have not made Pacific Northwest aluminum production competitive. Benton suggests BPA provide $20 million to retrain the DSI workforce. WPAG (DSI-090) stated there are "good and substantial" reasons for BPA to reconsider its decision to provide some benefits to the DSIs for the post-2006 period.

Finally, BPA noted at the March forum that a DSI service solution should account for BPA's one remaining small non-smelter DSI, Port Townsend Paper's 17 aMW paper mill load. In response, a number of parties commented that Port Townsend Paper should be treated separately. GNA (DSI-083) commented it supports separate treatment for Port Townsend given its relatively small power requirements (approximately 17 aMW), and because Port Townsend would have been served by its local utility (and paid a PF equivalent rate for its power) but for special historical circumstances that led to its DSI status. Cowlitz PUD (DSI-070) commented similarly, and stated it was not opposed to BPA providing "a modest level" of support directly to Port Townsend or indirectly through its local utility. Whatcom PUD (DSI-071) also supports BPA treating the Port Townsend load distinct from the DSI smelter loads, based on its comparatively small power requirements and unique operating characteristics.

Evaluation and Decision

At the outset, it is important to note that BPA is attempting to craft a compromise that will have a known and relatively small impact on the rates paid by its public preference customers, while still making available to the DSIs a level of service benefits large enough to materially improve the likelihood that power costs to the smelters will be low enough to facilitate smelter operations in times when such operations would otherwise be economically infeasible. However, it is not BPA's goal, nor is it within BPA's ability, to guarantee any particular level of DSI operations, even minimal levels. World aluminum prices, raw materials costs, and the financial health of the companies are beyond BPA's control and play at least as large a role in the feasibility of smelter operations as power prices. Many comments, both at the DSI forum and written comments, recognized this fact.

Additional important context is the fact that the amount of power provided by BPA to the DSIs has dropped from approximately 3,000 aMW a decade ago, to approximately 1,500 aMW under current contracts entered into for the FY 2002-2006 rate period. These contract amounts have also been significantly reduced by, among other things, contract terminations and aluminum company bankruptcies. Only half of the DSI contracts for the FY 2002-2006 period are still in effect, and the totals for power provided under these contracts, excluding the period of time the smelters curtailed load at BPA's request, will average less than 300 aMW. The fact that only 300 aMW of the original 1,500 aMW contracted for under the existing contracts was used is due principally to economic choices by the DSIs, highlighting the fact that BPA's power service decisions are only one variable in the economic and operating decisions the DSIs face. As already noted, BPA is not revisiting its earlier decision to serve some amount of DSI load at a known and capped cost. However, issues raised concerning the manner in which service benefits can or should be delivered are addressed in this record of decision.

While BPA's February 2005 straw proposal for 500 aMW of benefits with a $40 million cap generally set the bounds for the discussion, many proposals ranged higher and lower. Individual DSI proposals, which each company generally describes as the amount needed to maintain base-level operations at their respective smelters, total over 900 aMW. More importantly, the DSIs' proposals are each essentially uncapped. Each company made clear, given expected market power prices for the next rate period, that the $40 million cap was inadequate to facilitate smelter operations at even bare minimum levels. Using Alcoa's example of a delta of $18 per MWh between BPA's lowest-cost rate and the market, the Alcoa proposal would cost BPA approximately $70 million to serve 438 aMW of Alcoa load alone, almost $80 million to serve 500 aMW of DSI load, and over $140 million if the 900 aMW requested was served. Of course, given the inherent volatility of electric power markets, in high markets the delta would be wider, leaving BPA and its customers exposed to even greater costs. Proposals that leave the cost of service to the DSIs uncapped violate the principle already adopted by BPA that the cost of DSI service must be known and capped, and will not be adopted.

The partial and conditional acceptance by public preference customers of the $40 million cost of BPA's straw proposal makes clear that while there is some willingness to pay some part of the cost of providing the DSIs a limited amount of service benefits, there is little or no support by these customers for providing more benefits than proposed in the straw proposal. However, proposals that would reduce or eliminate altogether the 500 aMW and $40 million amounts, which could occur under some circumstances in the proposals by public entities, would likewise reduce or eliminate any reasonable likelihood that BPA service could have a meaningful, positive impact on the DSIs' chances to operate their facilities at even minimal levels during the next rate period. For example, many public customer representative groups, and others, proposed that BPA not provide any service to the DSIs if doing so would potentially increase the PF rate above $27 per MWh. BPA has not commenced the rate case that will establish the PF rate for the next period, so it is not known definitively at this time what that rate will be and it is therefore not feasible to tie the decision on DSI services to the PF rate level ultimately adopted by BPA. However, BPA is mindful that service to the DSIs will come at the expense of higher rates paid by its public preference customers, and is attempting to craft a compromise that balances those costs against providing a meaningful level of service benefits to the DSIs, but a proposal that will result in no DSI service benefits does not provide that balance.

BPA proposed the $40 million cap believing it would, in many expected power markets, provide enough value to the DSIs to close the gap between power market prices and BPA's lowest-cost rate. However, power market prices have significantly increased since the Regional Dialogue began in July 2004. The probability that a $40 million benefit will close the gap on an amount of power required for minimal operations has decreased. Recognizing this, BPA believes the balance between containing costs and providing a meaningful benefit to the DSIs is best achieved by increasing the average megawatt amount provided to 560 aMW, and increasing the cap to $59 million per year. These amounts exclude service by BPA to Port Townsend Paper (adding 17 aMW, for a total of 577 aMW), which as explained below will be treated separately from BPA's aluminum smelter customers. The following discussion and evaluation applies solely to BPA's provision of service benefits to the aluminum smelters. The argument by each of the DSIs is that the $40 million cap amount will be inadequate in light of the level of probable market power prices is supported by steadily upward trend in forward market index prices, and by BPA's own current forward market price snap-shots. The Mid-Columbia (Mid-C) index forward market prices for Fiscal Year (FY) 2006-2009 have continued to rise since the time of BPA's original

proposal in July 2004 and its straw proposal of February 2005, with current flat prices for FY 2007-2009 hovering around $50-$55 per MWh. At these levels, a $40 million cap would allow the DSIs to bring down their effective rate on a 500 aMW allocation to only approximately $40-$45 per MWh, which each has indicated is far too high to allow economic operation, even under robust aluminum market prices. BPA's own snapshot of forward prices for the FY 2007-2009 period likewise suggests that a higher cap is needed to create a reasonable probability of reducing the DSI rate, under most power market scenarios, to levels conducive to economic smelter operations.

A recent price distribution estimation by BPA for FY 2007-2009 flat power (average price of power over all hours of the day every day of the year) indicates that power market prices could be below $38 per MWh more than 30 percent of the time, at or below $42 per MWh approximately 40 percent of the time, and at or below $54 per MWh approximately 60 percent of the time. This means with benefits capped at $59 million (which translates into a $12 per MWh credit), BPA could provide 560 aMW of benefits to the DSI smelters at a theoretical PF-equivalent rate of approximately $30/MWh (bridging the $12 per MWh delta between the PF rate and a $42 per MWh market rate) 40 percent of the time during the rate period. Given this relatively low probability, in the event that BPA delivers service benefits through a financial mechanism (where the cost of supplying the DSI load cannot be achieved within the cost cap) BPA will provide the companies flexibility to spread this benefit over fewer megawatts, down to one-half of the megawatts allocated to the company, further increasing the probability of some smelter operations over a wider spectrum of market power prices. To be clear, BPA is not deciding that the smelters will have unlimited flexibility in terms of the amount of power supply to utilize the proposed financial benefit. Rather, the flexibility will range from the full allocation as the maximum rate of delivery, and the minimum rate of delivery will be one-half of the maximum. With this added flexibility BPA could provide 280 aMW of benefits (one-half of the 560 aMW) at the PF-equivalent rate. This flexibility provides the DSI's the ability to choose, under high market price conditions, to reduce smelter operations to one-half of their allocated amount. This would allow the smelters to double the potential $12 per MWh benefit and allow them (for example) to bridge the $24 per MWh delta between a theoretical $30 per MWh PF rate and a $54 per MWh market rate. Therefore, under the rough estimate of forward power market prices used here, BPA would be able to provide power prices equivalent to expected PF rates to allow a level of smelter operations approximately double current levels almost half the time, and approximately equal to current operating levels 60 percent of the time. BPA believes this level of benefits strikes the right balance between offering an amount of power at a rate low enough to help maintain – and provide opportunities to expand – DSI operations and employment, while keeping rates charged to its public preference customers as low as possible. However, the cap will not be raised further in the event BPA's updated forecast price distribution for the FY 2007-2009 rate period shows even higher market prices, nor will they be updated for changes in the forecast of market prices for the FY 2010-2011 rate case.

The two caps (560 aMW and $59 million) will work in tandem, and provide the maximum benefits that may be provided, but are not a floor level and do not represent the minimum amount of annual service benefits that will be provided to the DSIs. Power deliveries in excess of 560 aMW (or financial benefits based on more than 560 aMWs) will not be provided to the DSIs even if that could be done within the $59 million cap; likewise less than 560 aMW of power will be provided (or financial payments will be based on fewer than 560 aMW) where the $59 million cap would otherwise be breached. BPA believes the capped amounts provide a sufficient amount

of benefits to help sustain DSI operations under most power market conditions. If markets improve so that 560 aMW or equivalent financial benefits can be provided to the DSIs at less than $59 million, then BPA's other customers will have the impacts to their rates reduced by the savings. This is consistent with BPA's goal of enabling the DSIs to obtain enough low-cost power to help maintain minimal levels of smelter operations – other customers will not be asked to pay for more than this. In addition, these caps are annual caps, and benefits not used within a fiscal year, for any reason, will not be carried over into future years. BPA is imposing costs on its other customers beyond the $40 million cap in its straw proposal, and so it is necessary to maintain the annual cap to provide one possibility that the actual cost of the service benefit could be less than $59 million. BPA will ratchet down service benefits to the DSIs if providing the full amount would result in DSIs paying a lower rate than public preference customers. BPA's intent is that no DSI will pay prices that are lower than public preference customers pay for similar power products from BPA.

In addition to power sales contracts for an aggregate 560 aMW of benefits at a capped $59 million cost that BPA will offer to the aluminum company DSIs, BPA will offer, through the local public utility, a 17 aMW surplus power sales contract to Port Townsend Paper Company, under its market based rate schedule (or the IP rate if viable) at a price approximately equivalent to, but in no case less than, its lowest-cost PF rate. BPA is persuaded that Port Townsend's situation is unique among the DSIs and warrants unique treatment. The jobs provided by Port Townsend are over 10-times the number provided per megawatt at the aluminum smelters. By serving Port Townsend as described, BPA will simply be treating Port Townsend the same as similarly situated paper mills located within the Pacific Northwest and served directly by BPA's public preference customers. To be clear, service to Port Townsend is not included in the $59 million cap.

The decision to allocate 577 aMWs to the DSIs, while slightly higher than the original straw proposal of 500 aMW, represents a decrease of over 900 aMW of Federal power service to this customer group compared to the contracts signed by BPA and its DSI customers in 2001, and almost 2,500 aMW compared to contracts signed a decade ago.

Finally, on June 10, 2005, the United States District Court for the District of Oregon issued an injunction that, if sustained on appeal, will likely greatly reduce the amount of water available this summer for hydroelectricity production. The injunction calls for significant additional spill this summer, and BPA estimates the financial impact in the range of $57-81 million. While this record of decision is being issued subsequent to the court's injunction, BPA's evaluation of DSI service issues, and its decision making process on those issues, was completed prior to the injunction. If this injunction is sustained on appeal, and especially if summer spill along the lines ordered in the injunction is made a regular part of river operations, the rate impacts would be of extreme concern, and BPA may seek offsetting cost reductions. However, the injunction is under appeal, and the cost implications for this summer and the next several years are still unclear. A long-term cost increase of this magnitude would presumably have an impact on the DSIs ability to proceed with a take-or-pay contract. Notwithstanding this uncertainty, BPA has decided to issue this DSI service record of decision without specifically accounting for the potential costs impacts of the injunction on BPA's ability to deliver the DSI service benefits contemplated in this record of decision. However, BPA will review this decision prior to contracts being signed pursuant to this ROD based on more current information about the implications of the District Court's decision and its impact on future hydro system operations.

V. Issue 2 - Eligibility and Allocation

Comments on July 2004 Proposal

In its July 2004 Regional Dialogue policy proposal, BPA proposed that any benefits allocated to the DSIs would be targeted to DSIs that are creditworthy and have fully met their obligations under current rate period power sales contracts. However, BPA did not propose how it would allocate benefits among DSIs that otherwise meet any threshold criteria. Most of the comments BPA received in response (and that otherwise supported, or acquiesced to, some level of service to the DSIs) were supportive of BPA's proposed criteria. CFAC (RD04-0111) and Alcoa (RD04-0067) underscored the importance of creditworthiness and noted that they had met the criteria. Evergreen Aluminum (Evergreen, RD04-0075) noted that it too meets the eligibility criteria and has honored the terms of its current BPA contract. The State of Washington Department of Community, Trade and Economic Development (Washington DCTED, 0072), EWEB (RD04-0127), Franklin PUD (RD04-0108), PNGC (RD04-0114), WMG&T (RD04-0092), ICNU (RD04-0093), and Flathead Electric (Flathead, RD04-0048) also endorsed the eligibility principles. Tacoma (RD04-0103) argued against any service to the DSIs, but endorsed BPA's principles for service, including the creditworthiness criteria, if BPA did choose to offer some form of DSI service. While strongly objecting to any service to the DSIs, WPAG (RD-04-0105 and RD04-0150) proposed a number of additional eligibility criteria, including that the DSI had not declared bankruptcy, rejected its power sales contract in a bankruptcy proceeding, or imposed any stranded costs on BPA by "substituting market power for their Federal power supply."

On the other hand, GNA (RD04-0101), which filed for bankruptcy in December 2003, and some GNA employees, discounted the importance of creditworthiness (Mike Keith, RD04-0053 and Mark Pedersen, RD04-0171). GNA commented that a focus on past creditworthiness under the current power sales contract, given recent GNA financial difficulties, would unfairly discount its other previous responsible actions as a regional corporate citizen, and would only harm innocent employees and communities. GNA also stated that BPA has not been financially harmed by GNA's inability to purchase the 236 aMW of power to which it committed to purchase on a take-or-pay basis in its power sales contract, and that BPA has made more revenues from remarketing this power than it would have made if it had made the sales to GNA under the contract.

Comments on February 2005 Proposal

In its February 2005 straw proposal, BPA reiterated that it believed eligibility criteria for service benefits should center on each DSI's creditworthiness. BPA stated it believed the focus on creditworthiness was crucial to directing scarce benefits where they can best enhance the prospects for smelter operations and employment. As such, BPA indicated evidence of each company's ability to operate and create employment during times of difficult industry and company economics, such as experienced during the current contract period, should be a relevant consideration, and suggested an objective measurement of such ability could be the amount of energy used by each DSI during the current rate period to produce aluminum. BPA suggested that the power or financial benefit should only be provided in support of actual DSI operations and employment, and that the DSI must be purchasing and consuming an amount of power in support of production operations to receive any service benefits from BPA. BPA stated it wanted to understand the business plan of each company, and how the business plan explains the ability

of the DSI to operate under the market conditions that existed over the current rate period. In addition, at the March 2005 forum BPA indicated it believed a relevant eligibility consideration would be how, if applicable, each DSI disposed of its windfall remarketing benefits during the 1996-2001 rate period. BPA did not describe the application of the eligibility criteria to any particular company, or make any proposal on whether the eligibility criteria would be used to allocate benefits among companies that otherwise appear to meet the criteria.

Most comments from non-DSI customers and others expressed support that, at a minimum, the DSI must be creditworthy to receive benefits in the form of physical power deliveries. (*E.g.*, Whatcom PUD, DSI-071; ICNU, DSI-084; NRU, DSI-067; PPC, DSI-079; PNGC, DSI-088; WPAG, DSI-090; WMG&T, DSI-092; Wells Rural Electric Company, DSI-068; Clark PUD, DSI-069; Cowlitz PUD, DSI-069; SUB, DSI-076.) A number of comments suggested that BPA apply the same credit requirements as contained in BPA's contracts with its Slice customers. (CFAC, DSI-093; NRU, DSI-067; WPAG, DSI-090; SUB, DSI-076) Taking a different view, the Klickitat County Board of Commissioners (DSI-058) commented that "jobs and local economic benefits created by [the aluminum industry] outweigh any simple credit worthiness test" and that BPA should create a fair allocation process so that all remaining smelters in the region have a chance to succeed.

Some comments suggested additional criteria to qualify for service benefits, including: that the DSI "must have been operating continuously" (ICNU, DSI-084); that the DSI "provide prudential support up to the total amount purchased at the PF rate for the term of the contract" (WMG&T, DSI-092); that the DSI provide information to BPA demonstrating the number and location of jobs it will preserve or create, and anticipated wages (Central Lincoln PUD, DSI-066); that the DSI pre-pay monthly for power to be delivered by BPA (WPAG, DSI-090); that the DSI pay the cost of a put option to ensure that, in the event of a curtailment, the resale of power purchased for the curtailing DSI does not shift costs to other customers (NRU, DSI-067); that the DSI agree not to receive benefits from BPA after September 2011, that it demonstrate that its wages are equal to or better than the industry average, and that it demonstrate a commitment to non-BPA power sources in the long-term (SUB, DSI-076). There was no disagreement with BPA's proposal that the DSI must be purchasing power in support of smelter production in order to receive service benefits from BPA.

GNA (DSI-011 and DSI-057) strongly disagreed with BPA's proposed criteria, stating the criteria "appear to have been structured to favor specific companies instead of focusing on expected viability of smelters" in the upcoming rate period. In particular, GNA is opposed to any criteria that includes an examination of each company's operating performance during the current rate period. GNA argues that BPA's eligibility criteria ignore the dominant role power prices play in smelter viability, that allocating benefits based on eligibility criteria that include past performance will essentially predetermine which of the DSI aluminum smelters succeed or fail, and that "choosing which smelters should succeed or fail and which communities must suffer the attendant economic dislocation is not an appropriate role for BPA." (DSI-011) This comment was echoed by Whatcom PUD (DSI-071) and certain members of Congress (Baird, *et al.*, DSI-057). Likewise, WPAG (DSI-090) rejected any eligibility criteria aside from the DSI being creditworthy, noting that the element of BPA's straw proposal that suggested BPA would evaluate the viability of each DSI's business plan and operating capability would place BPA "in an untenable position" and that BPA should not judge which smelters receive power and which do not. On the other hand, PNGC (DSI-DSI-088), NRU (DSI-067), SUB (DSI-076), and Clark PUD

(DSI-069) argued that having fulfilled prior contractual obligations should be a prerequisite to receiving service benefits. PNGC commented that whether a company has honored its past obligations "is a key concern" in light of the fact that its members and other customers have been required to pick-up the cost of BPA write-offs of uncollectible DSI debt. NRU argues that a distinction should be drawn between those DSIs that are currently operating and those that are shutdown, since the former "have helped to pay BPA's costs during a very difficult period." (DSI-067)

GNA (DSI-011) argued that the most important circumstances influencing smelter operations in the current rate period, such as the price of aluminum and alumina, the volatile cost of electricity, and the value of the dollar, are not predictive of a company's ability to operate in the next period. GNA noted also that it has emerged from bankruptcy having shed most of its debt, and with new "strong, very credit worthy" majority ownership. GNA urged BPA merely to specify the amount of power system benefits it will make available to support actual smelter operations, and provide such benefits (in the form of a financial transaction) to those smelters that do operate in proportion to their actual level of operations. GNA argues its proposal will avoid BPA "tilting the playing field" and better promote job preservation and creation since it will allow the marginal or "swing-smelters" to maintain minimum viable levels of production under virtually all conditions, whereas BPA's eligibility criteria will likely allocate all available benefits to smelters that will operate with or without such benefits, without creating or sustaining jobs. Alternatively, GNA suggests that if BPA does specify allocations for each smelter, that allocating 100 aMW per smelter would be the best way to support some level of operations by each company. Finally, GNA noted in additional written comments that it would support a decision that allocated 500 aMW "on a non-discriminatory basis" and that any BPA allocation "simply needs to give each remaining smelter a chance to succeed." (DSI-083).

Alcoa (DSI-077 and DSI-057) stated that it is a creditworthy company, that it has met all its obligations under "current and past" BPA contracts, and that it "will not bring unfair risks to other customers." (DSI-057) Alcoa consistently stated that it wants 438 aMW of power from BPA and did not propose any other allocation scheme in the face of BPA's straw proposal limiting DSI service benefits to 500 aMW. However, Alcoa argues that spreading limited benefits among several smelters means that "none of the Northwest plants that rely on BPA power will be able to compete in the long run." (DSI-077) It stated that short of extending all DSI contracts in their current amounts, that BPA should allocate whatever amount of power is made available for DSI service to "the plants that will make the best partner for BPA and its customers" *Id.* As noted under Issue 1, a number of Washington State legislators and Alcoa employees (Sen. Finkbeiner, DSI-049; Reps. Morris and Chopp, DSI-051; Rep. Chandler, *et al.*, DSI-081; Rep. Linville, DSI-082; Sen. Brandland, DSI-050; Dennis Van Beek, DSI-008, L. Engler, DSI-006, and others) submitted comments supporting Alcoa's request for BPA to provide physical power equal to Alcoa's current contract amount. Businesses located in the community where Alcoa's Intalco plant is located (Diehl Ford Inc, DSI-028, Peoples Bank, DSI-029, and others), educational and environmental associations (Bellingham Technical College, DSI-013, Nooksack Salmon Enhancement Association, DSI-014, and others) and the Mayor of Ferndale, Washington, (City of Ferndale, DSI-016) commented expressing support for Alcoa's proposal. On the other hand, the mayor of Goldendale, Washington, argues the Alcoa proposal is unfair to smelters located in areas with the highest unemployment, and urges BPA to "just be fair about the allocation." (City of Goldendale, DSI-027).

CFAC proposed, assuming each of the remaining smelter DSIs meets its proposed credit prerequisites (the Slice contract credit requirements), that 323 aMW of the 500 aMW in BPA's straw proposal (plus 17 aMW for Port Townsend) be allocated as physical power deliveries among DSIs that currently have contracts with BPA, each to receive a physical delivery of the lesser of 100 aMW or its current contract amount, for a total of 306 aMW. *Id.* The balance (194 aMW) would be allocated evenly between CFAC, Alcoa, and GNA, and the value of the allocation monetized, up to a capped dollar amount. CFAC proposed that if any allocated benefits are rejected by a company, or if a company cannot meet the credit prerequisites, then those benefits would be reallocated among the remaining smelters pro rata. Whatcom PUD (DSI-071) also supports reallocating unused benefits. PPC (DSI-079) commented that it opposed proposals that would reallocate benefits in the event one or more of the companies could not utilize them, and that benefits should instead be determined on a company-by-company basis, but did not make a specific allocation proposal. Many parties submitting comments did not make specific allocation proposals.

However, several parties did make specific allocation proposals. The cost caps and other rate conditions associated with these allocation proposals, and the mechanisms proposed by parties for delivery of the allocated benefits, are discussed under Issues 1 and 3. In general, however, as noted almost all parties commented that the DSI must be creditworthy to receive an allocation of benefits. NRU (DSI-067) proposed that up to 300 aMW in aggregate be offered to DSIs equal to the amount of power each purchased from BPA in the current rate period. An additional 200 aMW in aggregate would be made available on a pro rata basis. Wells (DSI-068) commented that it agreed with NRU's proposal. WPAG (DSI-090) proposed what is essentially a pro rata allocation formula. Under the WPAG proposal, BPA would request load commitments from all DSIs on a quarterly or semi-annual basis. If the load requests exceeded 500 aMW, BPA could serve the increment above that amount so long as the $40 million annual cost cap was not breached. WMG&T (DSI-092) made a similar pro rata allocation proposal.

Evaluation and Decision

BPA will allocate a share of the 560 aMW of service benefits to each DSI aluminum company for purposes of making an initial offer of service, but the creditworthiness of each DSI, on a going-forward basis, will determine whether BPA executes a contract with a company. In order to protect its financial position to the fullest extent possible, in particular in the case where BPA must purchase some amount of power in the market to provide benefits to the DSIs, BPA will establish and apply uniform creditworthiness criteria. In the event that BPA's credit evaluation of a company concludes credit assurances are required to mitigate BPA's risk from the company's lack of creditworthiness or performance viability, then BPA will require the company to provide performance assurances acceptable to BPA and consistent with the credit assurance provisions contained in the credit agreement by and between BPA and its Slice customers.

Several parties suggested only companies that have met all their obligations under the current power sales contract should be eligible for an allocation of service benefits. The only DSI that has failed to do so is GNA, which filed for bankruptcy protection in December 2003. At the time the bankruptcy petition was filed, GNA had outstanding unpaid balances billed by BPA for take-or-pay damages associated with several power sales contract curtailments. BPA is an unsecured creditor of GNA, and will receive its pro rata share of the distribution to unsecured creditors as provided for in the plan of reorganization approved by the court. The value of the distribution to BPA will be quite small in relation to the amount claimed. Although receiving so

little value is frustrating, a decision to deny GNA an offer of service benefits in the next rate period solely because it filed for bankruptcy protection and failed to pay BPA in full raises difficult questions regarding the policy of the bankruptcy code to afford debtors a fresh start. In addition, such a result would certainly not benefit GNA workers and the communities in which the GNA smelters are located. Nevertheless, GNA (or more accurately the reorganized entity that is its successor) will have to establish its creditworthiness, or post credit assurances acceptable to BPA if that is required, in order for BPA to execute a power sales contract with the company. As noted by several parties, however, if BPA monetizes the value of a company's power sales contract in lieu-of a traditional physical power delivery form of service, then the creditworthiness issue is less important, since the company itself would arrange its own physical power supply, with BPA providing an after-the-fact credit.

Contrary to the comments submitted by GNA and several others as well, BPA continues to believe that a company's record of operation under the current power sales contract is a credible, objective measure of an aluminum smelter's ability to operate in the next rate period on a sustained basis. Nevertheless, BPA is persuaded by the comments of GNA and others that this criteria, in and of itself, is an imperfect measure of that ability and that BPA should strive not to have an assessment of viability predetermine whether a company is offered an allocation of benefits.

BPA has concluded that it is important to allocate now among the companies the amount of service benefits each will be offered in a contract for the FY 2007-2011 period, and each company's past operating performance has played some role in that allocation. A pre-allocation of service benefits from BPA will provide each company with a known power supply base, at a known cost, upon which to make arrangements now for its additional power supply needs in the market. This level of certainty is not available under the various pro-rata allocations proposed by several parties. Pro-rata allocations would necessarily occur much closer to the date of the commencement of service, since it is entirely possible, for any number of reasons, that one or more of the companies may decline BPA's offer of service. While this is just as possible under a pre-allocation, BPA has attempted to equitably allocate the service benefits based on each company's stated minimal needs, and each company's demonstrated ability to operate during the current contract period, which BPA believes are reasonable and objective indications of each company's ability to accept and use the allocated benefits. The pro-rata allocation schemes do not adequately take these factors into account, or account for substantial differences in smelter size and operating characteristics. Given each company's stated minimal requirements and current operating posture, a pro rata allocation that is not determined until later is a less efficient way to allocate these scarce benefits compared to a pre-allocation. Each company's allocation will be based on a combination of its stated minimum requirements and current contract period operating posture. The result is that each company will receive a smaller allocation than it indicated it would like to have, but a larger allocation than each has used under the current power sales contracts. CFAC and Alcoa have chosen to operate their Columbia Falls and Intalco smelters well below capacity and BPA contract amounts, purchasing Federal power, and at times market power, to run approximately one potline at each facility. This represents approximately 70 aMW in the case of CFAC, and approximately 177 aMW in the case of Alcoa. GNA has not operated its Dalles smelter at all during the current contract period, using fewer than 50 aMW of power at its Goldendale smelter for the first 19 months of the current rate period, and none since shutting down operations in April 2003. GNA has curtailed its entire remaining load for the remainder of its contract term. CFAC and Alcoa, and their workers, have made it clear that they

believe that to be successful in the future they will need to have the ability to increase their current production levels. CFAC has requested 171 aMW, and Alcoa has requested 438 aMW. BPA has decided to provide CFAC and Alcoa the opportunity to increase their production by allocating benefits to them that will allow each to potentially increase its production to approximately two potlines at each facility. For CFAC, BPA has decided to provide 140 aMW worth of benefits, for Alcoa BPA has decided to provide 320 aMW worth of benefits. BPA has decided to allocate 100 aMW of benefits to GNA, which will provide the newly reorganized company an opportunity to ramp-up from its current shutdown status to a significant level of smelting and local employment, providing GNA with the "pilot light" it requested. Port Townsend will be provided 17 aMW as previously discussed. BPA will not allocate any benefits to Evergreen Aluminum for the next rate period. Evergreen, which elected in 1996 to reduce its power sales contract relationship with BPA to 10 aMW (an amount reduced further in its current contract to 6 aMW), is currently mothballed and has not operated since December 2000. BPA cannot justify diluting the allocations of the other smelters on the remote possibility that Evergreen will operate during the next rate period. However, Glencore, which owns both the CFAC and Evergreen smelters, will be permitted to reallocate up to 6 aMW of the CFAC allocation to Evergreen to continue to serve Evergreen's ordinary station service needs. No other DSI – current or former – requested service and none will be offered.

BPA has also decided to develop a "use-it-or-lose it" provision in the DSI contracts that will offer an opportunity to permanently reallocate benefits not used by a company over the course of one year. The amounts not used during a current year will result in reducing costs to other Federal power customers and these unused benefits will not be carried over to a future year as part of the reallocation. This provision will reward smelters that successfully operate with the opportunity to acquire unused benefit amounts from other less successful companies, allowing future market conditions to rebalance the benefit levels and allowing companies to potentially increase their initially allocated benefit levels. However, no company will be reallocated an amount of benefits in excess of its current BPA power sales contract. For Alcoa the maximum is 438 aMW, for CFAC the maximum amount is 171 aMW, and for GNA the maximum amount is 236 aMW. The reason for capping the amount any individual DSI may receive to its current contract allocation echoes the reason the benefit caps are ceilings and not floors for benefit levels, and BPA will not ask its public preference customers to help underwrite the operating level of any DSI beyond existing contract levels.

VI. Issue 3 - Delivery Mechanism

In simplest terms, in addressing this issue BPA must resolve how it can best structure the new contracts to deliver 560 aMW of service benefits to the aluminum smelter DSIs without breaching or creating the possibility of breaching the $59 million annual cost cap. The two primary elements to be considered as part of this structure or "delivery mechanism" are the rate schedule that will be employed, and whether benefits will be delivered as: (1) physical power, or (2) the value of a physical contract monetized, based on its relative market value, and paid to the DSIs. As part of its July 2004 proposal, BPA indicated it was examining offering eligible DSI loads a "defined and limited financial incentive to operate" in place of a traditional physical power sale under the Industrial Firm (IP) rate. BPA stated that in order to implement this mechanism for delivering benefits, in which BPA would pay the DSI the difference between the cost of the DSI's market power purchases and the cost to BPA of serving the DSIs in the traditional manner, it would need to be assured that the cost impact on other customers was

"roughly no greater than if BPA had exercised its discretion to serve the DSI customers" directly with physical power deliveries using the IP rate. BPA noted this approach eliminated the take-or-pay risk associated with a physical power sale for both BPA and the DSIs, while providing additional operating flexibility to the companies, and allowing them to make operating decisions in light of the availability of the financial credit from BPA. BPA's principal goals behind this proposal were to eliminate the inherent risk and cost uncertainty associated with augmenting the Federal system to serve DSI load and to minimize the risk of bad debt even in the case of bankruptcy.

Comments on the July 2004 Proposal

A number of comments to the July 2004 proposal addressed the financial incentive concept. While a few parties (WPAG, RD04-0105 and RD04-0150; Columbia River PUD, RD04-0031; NRU RD04-0073), commented that BPA has no legal authority to provide financial benefits to DSIs, or stated a preference for a physical power sale (ICNU, RD04-0093), most parties that commented on this issue were at least open to the financial incentive approach. Alcoa (RD04-0067) and CFAC (RD04-0111) stated a preference for a power sale at a PF-equivalent rate, but CFAC noted it would be open to a financial incentive approach to service, and Alcoa stated it would consider a "fair settlement" of a power sales contract in the form of a financial incentive to operate. However, in arguing for a physical power sale, Alcoa noted BPA "should not expect zero uncertainty" surrounding the cost to serve DSI load with purchased power, and that there were options for mitigating that cost and risk uncertainty. GNA (RD04-0101) expressed support for the concept of monetizing the value of a power sales contract to eliminate the risk to BPA associated with a physical power sale, and proposed an exchange mechanism that might be used to structure such a transaction. Under this exchange, the incentive amount would equal the difference between the market price forecast BPA establishes in the power rate case, and the IP rate that is also set in the rate case. The DSI would offer to "sell" power to BPA at the market price, and BPA would simultaneously "sell" an equal amount of power at the IP rate, but the transaction would be monetized, providing the DSI an amount of money to offset its actual market power purchases.

NWEC (RD04-0110) strongly supported a financial mechanism in lieu of a power sale and noted its similarities to earlier proposals they had made which would encourage smelting during low price periods and discourage it during high price periods. The State of Washington Department of Community, Trade and Economic Development (RD-0072), Springfield (RD04-0106 and RD04-0158), city of Sumas (RD04-0132) and Tacoma (RD04-0103), also endorsed the financial incentive approach to delivering benefits. Flathead Electric (Flathead, RD04-0048) expressed support for the financial incentive if transitioning DSI load to a local utility was not feasible. Northern Wasco (Northern Wasco, RD04-0042) also expressed support for the financial incentive, but noted it would ultimately support a "more prudent" approach if one presented itself. Western Montana G&T (WMG&T, RD04-0092) and Lincoln (RD04-0100) expressed openness to the concept of a capped financial incentive so long as it did not allow any gaming by the DSIs.

Through the various regional dialogue venues some customers began suggesting that perhaps BPA service to DSI load should be delivered via the local utility of each DSI. The rationale behind this idea was essentially two-fold. First, that it would eliminate the DSIs as a separate class of customers, thereby eliminating many of the rate setting and other service complexities that status now presents to BPA and the region. And second, that it would begin the process of moving decision-making regarding service to these large loads into the communities in

which the facilities, and the jobs that go with them, are located. Alcoa (RD04-0067), Whatcom PUD 1 (RD04-0146), Klickitat PUD (RD04-0144), and Flathead (RD04-0048) proposed that BPA be open to serving former DSI loads through their local utilities, but generally did not specify whether they supported monetizing the transaction. Whatcom commented BPA should transition DSI power supply responsibility to the local utilities, thereby allowing BPA to move out of the DSI business and local utilities to support the local economies in which the DSIs operate. Whatcom, Klickitat, and Flathead each have DSI smelters in their service territories. On the other hand, Clark PUD (DSI-069), in whose service territory CFAC's sister smelter Evergreen Aluminum is located, expressed strong objections to participating in any arrangement to serve the smelter load, since it could "be left holding the bag if a DSI did not pay for its power." BPA's investor-owned utility customers (IOUs, RD04-0157) also addressed the issue of BPA service to the DSIs via local utilities, and cautioned BPA that service through the local utility could have "unintended consequences" for BPA's New Large Single Load Policy. PNGC (DSI-088) stated it was "too late in the game" to try and place the DSIs on the same basis as other industrial loads served by local public utilities, and that it was concerned about the risk to the individual utilities in a transaction where they stood between BPA and the DSI.

Comments on the February 2005 Proposal

BPA's February 2005 straw proposal to "provide financial benefits in lieu-of" a physical power sale remained essentially unchanged from the July 2004 proposal. BPA explained that this "mechanism monetizes, or converts to cash, the financial value of a physical power sales contract." BPA's principal rationale for proposing this mechanism remained that it allowed BPA "reliably to meet the requirement that the benefits be capped," while noting that "other mechanisms may meet this requirement as well." However, in place of focusing on the IP rate as the rate schedule vehicle off of which service benefits would be calculated, BPA proposed that one alternative to be considered, and its preferred path, was to structure the transaction as a surplus power sale to the DSIs through the local serving public utility district. BPA explained that this would take the form of a three-party power sales contract, with the first leg of the transaction being a below market surplus power sale by BPA to the local utility under BPA's firm surplus power rate schedule, and the second leg being a re-sale of this surplus by the local utility to the DSI. In order to eliminate the risks to the parties associated with a physical power sale, BPA's proposal contemplated that the value of the transaction would be monetized, the value being the difference between the below market surplus power and the forecasted market price for power. The principal reason for moving away from an IP rate based solution was that it is becoming more clear as BPA prepares for the upcoming power rate case that it is unlikely the IP rate can be established at a level low-enough to even approximate the PF rate.

In response, and in something of a reverse from the leanings of prior comments, most comments reflected a preference for benefits to be delivered through physical power sales. WPAG (DSI-090), Western Montana G&T (DSI-092), Snohomish County PUD (DSI-075), PNGC (DSI-088), Northern Wasco PUD (DSI-074), Klickitat PUD (DSI-064), ICNU (DSI-084), the DSIs, Ferndale community leaders, most Washington State legislators, and numerous DSI employees comments either expressly or impliedly favored a physical power sale over BPA's proposed financial approach. WPAG (DSI-090) argued that any power sales contract that the parties intended ahead of time to monetize was a "sham transaction that is being proposed merely as a pretext to enter into a financial transaction under which BPA would deliver money to the utility rather than power." As an alternative, WPAG proposed that BPA make a power sale

directly to each DSI "at the DSI rate, which would be equal to the PF rate." Western Montana G&T (DSI-092) equated monetizing the value of the power sales contract with a "financial subsidy to industries" and that it did not believe that was good public policy. It agreed the financial transaction had certain benefits, but that it was "a little too tricky" and that a physical power sale to the DSIs would be the superior alternative. It proposed that BPA simply purchase and allocate as much as each DSI requested up to the cost cap, or on a pro rata basis in the case requests exceeded supply, a five-year flat block of power. PNGC (DSI-088) stated that while it understood BPA's rationale for preferring to monetize the transaction and eliminate the risks of a physical transaction, it had concerns about "the legal mechanics" of that approach. It argued a physical power sale is simpler and "provide closer alignment with other customers." Snohomish, DSI-075, proposed that BPA should consider a one-time augmentation of the Federal system by buying-back a portion of the power BPA delivers to Canada pursuant to the Canadian Entitlement to serve the DSIs, thereby avoiding the expense of adding new transmission and facilities in western Washington.

Other commenters were supportive or willing to consider the financial approach over a physical power sale or a combination of the two for a service benefit package, including each of the DSIs. Springfield (DSI-076) argued that a physical power sale would result in higher costs or a loss in surplus revenue, that benefits should be financial only, and based on the difference between the IP rate and the Mid-C index price. The State of Washington, Department of Community, Trade and Economic Development (DSI-072) commented that monetization of a power sale, as proposed by BPA, is the most practical way to implement the DSI benefits. NRU (DSI-067) and CFAC (DSI-057 and DSI-093), each proposed a combination of a base amount of physical power and financial payments based on an additional allocation. The PPC (DSI-079) did not state a preference for a physical or financial approach, but cautioned BPA not to use a delivery mechanism "that relies unduly on BPA's settlement authority," a reference to the monetary settlement of BPA's obligation to provide residential exchange benefits to its investor-owned utility customers, which is currently the subject of litigation.

Evaluation and Decision

BPA's evaluation of this issue is driven by the principle adopted in July 2004 that any service benefits provided to the DSIs in the next rate period must be at a known and capped cost. Service delivery mechanisms that do not meet this principle with a very high degree of certainty create risks the agency cannot afford. Many customers, including the DSIs, have urged BPA to deliver benefits to the DSIs through a traditional physically delivered power sale. At the outset, it is important to note BPA very likely would be required to make market purchases for at least some portion of the 560 aMW (or less subject to the $59 million cap) of physical power service. Meeting the cost cap under a traditional physically delivered power sale at a fixed contract rate presents a number of payment and market risks that must be mitigated, and power supply decisions that must be managed.

Under either physical or financially settled approaches, the determination of how costs associated with serving DSI load will be allocated to other customers' rates is a rate case issue. However, the Slice contracts and rate methodology contemplate costs for serving DSI load during the FY2007-2011 period, and the costs of serving the DSIs will be allocated between Slice and non-Slice customers consistent with applicable legal requirements. It is an essential condition of this decision that costs are shared among all Slice and non-Slice customers.

One risk BPA would face in connection with a physically delivered power sale is the potential default on payment of the contract rate by the DSI. If the DSI fails to pay the contract rate to BPA, then the cap is in jeopardy of being breached during periods when BPA must remarket unused DSI power at prices below the contract rate. For example, assuming a contract rate of $30/MWh and market rate of $42/MWh, BPA would spend the entire cap amount to serve the DSI load for one year. However, for the cap not to be breached each DSI must pay BPA the full contract rate – BPA's service benefit is limited by the cap to $12/MWh in this example. If a DSI fails to take and pay for 150 aMW in a given one-year period, and the market price for power has slipped to below the $30/MWh contract price to $27/MWh, then BPA has breached the cap by the $3/MWh difference times 150 aMW, or approximately $4 million over that one year period. Of course, BPA has also incurred a sunk cost of $16 million on this 150 aMW, or the cost of bridging the delta between the contract rate and the market rate at which it purchased the power for the DSI. This is money that has been wasted in the effort to preserve jobs. To mitigate this risk, in the event BPA elects to directly or indirectly physically deliver power to a company, BPA will apply a rigorous application of credit assurance tools. Corporate guarantees or letters of credit, or some combination, are instruments that can be used to mitigate this risk. BPA could also require the company to post cash-collateral to secure its payment obligations under specified circumstances agreed to in advance.

However, the greater risk associated with a physical power sale is that the cost of market purchases to serve the contracted load will exceed the cap due to rising market power prices. In its last power rate case, BPA projected that service to the DSIs could be achieved with $28 per MWh market purchases, but actual market prices had increased several fold by the time BPA was making system augmentation purchases. These purchases were at rates far higher than the rates charged by BPA for DSI service. The only clear way to eliminate the risk of breaching the cap due to escalating market prices (other than through a block purchase at the beginning of the rate period for the full contract amount at a price at or below the cost cap) would be through a contract provision that excused BPA from providing the DSI with power as soon as BPA had incurred costs equal to the DSI's annual allocated share of the cost cap. But this is impractical for a number of reasons, leaving BPA under some circumstances with residual remarketing risks, and creating too many operating uncertainties for the DSI.

A number of parties supported BPA's straw proposal to deliver benefits through a financial mechanism that monetizes the value of a surplus below-market power sales agreement, up to a capped amount. While the DSIs have expressed a preference for physical power deliveries, they each also stated they were open to the financial approach to delivering benefits, and both CFAC and GNA made specific proposals regarding how the financial approach could be structured. The financial approach has some inherent advantages compared to a physically delivered power sale. First, it provides the only way to meet the cost cap prerequisite with certainty. This is because the financial benefit would be paid after-the-fact based on each DSI demonstrating that it has used power purchased from the market to operate. The exact number of megawatt-hours used is known, as is the market price (whether it is a set forecast price or the price actually paid by the DSI for its market purchases). BPA can therefore calculate and pay benefits with precision up to the cap. There is no market or payment risk because BPA will not have purchased power, which effectively eliminates the take-or-pay risk to both BPA and the DSI. Second, and contrary to the comments expressed by some parties, BPA believes the financial approach is simpler than a physical power sale to administer. The DSIs' creditworthiness and performance viability are substantially reduced as considerations that must

be dealt with, and BPA is not forced to design and execute a physical power supply strategy. Third, the financial approach leaves power purchasing decisions and associated market price volatility risks with the DSIs, which is more consistent with BPA's goal to limit costs and control risks. However, as noted in the comments, for various reasons, many customers are wary of the financial mechanism.

In sum, BPA recognizes there are implementation advantages and challenges associated with each delivery mechanism. However, because of the financial risks inherent in providing a physically delivered power sale and in order to meet the known and capped cost prerequisite, BPA's default delivery mechanism will be to monetize the value of the below-market power sales contract, providing the service benefits through cash payments. However, in light of the strong support by many parties for a physically delivered power sale, BPA will retain an option to provide physically delivered power in-lieu of monetizing the transaction. Whether the physical delivery option is exercised will be based on BPA's evaluation of whether any credit risks of a physically delivered power sale to a company have been adequately mitigated, and whether BPA can supply the DSI load, including locking down any necessary market power purchases, on a fully hedged basis at a cost at or below the cost cap. BPA will have this option under each power sales contract, exercisable by BPA under terms to be determined in the development of the contracts. Absent BPA exercising this option, each power sales contract will be monetized.

Under the default monetization of the power sales contract, payment will be made to the DSI only if it has operated its smelter. Exactly how the payment will be calculated, including any operating level requirements, and how the market price will be established, will be determined through contract negotiation. In addition, the contract will provide that the value of any monetization will be limited to ensure that the DSI is not paying less for power than public utility customers on a dollar per MWh basis. Payments to any DSI will be limited if such payments would cause the DSI's net cost of power (for the portion supported through the BPA transaction) to drop below the flat PF rate equivalent. Consequently, BPA will not provide any benefits for DSI loads at prices at or below BPA's PF rate for an equivalent product. The contracts, which will be offered for regional review and comment for consistency with the above principles, will not contain terms more favorable than those offered other customers.

Because the IP rate does not appear to have a high likelihood of being a viable rate for DSI service in the next rate period, BPA plans to offer power sales contracts in the amounts determined herein as surplus power transactions under its surplus power rate schedule. BPA plans to use firmed secondary surplus as the supply source. BPA will set the price for the sale at $12 per MWh below projected market prices, with the contract price shaped to match each company's load shape. The use of secondary firm surplus as the resource basis for the proposed surplus sale may appear to eliminate some of the cost uncertainty related to serving this load. It does not. BPA's secondary surplus has an opportunity cost value equal to the market value as that secondary is produced. Therefore, the risk of market price volatility associated with this supply source is as great as the price risks associated with market power purchases where BPA physically supplied the DSI load. Pricing the proposed surplus sale at $12 per MWh below the projected market and monetizing the transaction allows BPA to produce a defined value that will not exceed $59 million per year.

In addition, most of the public utilities whose service territory includes a smelter indicated a willingness to partner with BPA and the DSI in a three-party contract arrangement. BPA intends to work with these utilities if they desire to play a role in serving the DSI located in their

community, for the purpose of supporting their local economies. Among other things, BPA will work with the utilities to ensure that they bear minimal financial risk associated with the transaction, be it a purchase and re-sale of surplus power if BPA exercises its option to physically deliver, or the delivery of the equivalent financial value of those surplus transactions under the default mechanism. Some comments cautioned BPA that providing service benefits to the DSIs through the local utilities raised New Large Single Load (NLSL) issues. BPA does not believe DSI service provided as a surplus power sale, transacted through a three-party surplus power contract including the local utility, will violate BPA's NLSL policy. The fundamental distinction between the surplus sales proposed here, and a sale to the public utility to serve new industrial load on a requirements basis, is that the sale here is a discretionary sale that could be made directly by BPA. These contracts do not create new public utility preference load that must be served by BPA at the PF and/or New Resources (NR) rate, the rate typically used to serve new large single loads.

VII. Issue 4 - Credit Support

In its July 2004 proposal BPA sought comment on whether it should pursue offering the DSIs credit support in efforts they may undertake to build energy resources to serve their smelter loads. While credit support could take a number of forms, the most likely would be where BPA would agree in a power sales contract to serve as a back-stop purchaser of the resources output, guaranteeing that cost, including debt service, are paid up to a certain capped amount. While credit support could be structured to cap and limit BPA's absolute cost, it would likely carry significant market and transactional risk that BPA would actually be called upon to make payments under the credit support, up to negotiated limits. BPA did not make any proposal regarding credit support in its February 2005 straw proposal.

Parties' Comments

GNA (GNA, RD04-101) stated that it believes it is appropriate for BPA to provide credit support for generating facilities developed by DSIs to enable transition permanently off the BPA system. It provided some specifics from previous credit support discussions it had undertaken with BPA, and asked that BPA not foreclose the option of credit support. A couple of GNA workers (Keith, RD04-0053 and Geary, RD04-0053) noted their agreement with credit support as an option. Several comments (EWEB, RD04-0127; SUB, RD04-0106, Idaho Falls, RD04-0023; PPC, RD04-0109; ICNU, RD04-0093; and Alcoa, RD04-0067) expressed opposition to credit support. Alcoa underscored that it did not need credit support, and that providing it would be inconsistent with BPA's creditworthiness prerequisite. Alcoa also noted that it did not believe new generation was a viable energy alternative for its facilities given existing natural gas prices. EWEB was concerned that BPA could incur financial exposure beyond the cost of providing DSI service, and the PPC stated it did not think it was BPA's job to act as the DSIs' banker.

Evaluation and Decision

With the exception of GNA and GNA employees, the comments on credit support overwhelmingly opposed BPA providing credit support. Alcoa's comments that the current cost of generating resources are too high for smelting echoes BPA's conclusion that the cost of new resources continues to be much higher than levels needed for profitable smelting. Efficient gas-fired combustion turbines produce power at prices that appear too high to enable economic smelter operations, when viewed in combination with expected natural gas, alumina, and aluminum market prices. BPA is also concerned with the credit risk and potential costs credit

support would entail. GNA's comments included an attachment outlining a proposed credit support deal negotiated with BPA. Based on BPA's analysis of that proposed deal at the time (an analysis that holds true today), BPA does not believe that providing credit support is likely to meet the key principle, established by BPA in connection with previous credit support discussions, that such actions will actually enable aluminum production and maintain Pacific Northwest jobs. Absent a reasonable expectation that this principle can be achieved through credit support, and in light of the weight of comments against credit support, BPA cannot endorse further pursuing credit support at this time.

VIII. Other Issues

There are several other issues not raised specifically by BPA in either the July 2004 or February 2005 proposals, but which were raised by parties in comments. Those issues, to the extent they have not been evaluated above, are briefly discussed and evaluated here.

A few parties questioned whether the DSIs should provide reserves to BPA, including stability reserves. BPA's transmission function is responsible for procuring stability reserves, and the only reserves that BPA's power function would procure from the DSIs are so-called operating reserves. Operating reserves, also sometimes referred to as contingency reserves, allow BPA to interrupt (or curtail), specified amounts of DSI load. The value of operating reserves depends on, among other things, how much notice of interruption is required, how long the load may be interrupted, and how frequently it may be interrupted. Until the current contract that was signed in 2001, operating reserves had been provided by the DSIs, with the cost paid through a downward adjustment to the IP rate. Therefore, BPA paid for reserves whether it used any or not. In general, however, operating reserves can now be purchased more cheaply by BPA in the market when and if needed. CFAC (RD04-0111) requested that reserves, other than stability reserves, be negotiated bilaterally between BPA and the companies. Washington State Representatives Jeff Morris and Frank Chopp (DSI-051) commented that the value of spinning reserves provided by Alcoa was a consideration in Washington providing Alcoa a tax relief package. The current power rate schedule provides that BPA may obtain operating reserves from DSIs at a negotiated price, up to a price cap. The price paid depends on the quality of the reserves provided. BPA has not purchased any operating reserves from the DSIs under the current contracts. However, to ensure such reserves are available if needed and not otherwise available more cheaply in the market, BPA will establish a successor operating reserves provision in the upcoming power rate case along the lines of the current schedule.

Alcoa (DSI-057) proposed something akin to, but fundamentally different from, a standard operating reserve product, which is used to help remedy real-time system emergencies. Alcoa is willing to adopt long-term curtailment of smelter operations to protect BPA and its customers from extreme market rates, provided BPA reimburses Alcoa for the cost of the shutdown. Under Alcoa's proposal, it would curtail operations if wholesale market prices are expected to be above a certain level over a period of time. Alcoa used an example of $150/MWh over a 12-month period. Alcoa indicated this is a valuable "catastrophic insurance" policy that will help protect all BPA customers from "future extreme price excursions." Several Washington State representatives and Alcoa-Ferndale employees (Representatives Bruce Chandler, Jan Shabro, Dan Newhouse, Jim Clements, Mike Armstrong, Doug Ericksen, and Jan Rodne (DSI-081), aluminum employees Terry Easterwood, DSI-003, Marshall Mahala, DSI-024, and others) argue that Alcoa's proposed catastrophic insurance would put a cap on high power costs. Jim Lobdell-PGE (DSI-057), and NWEC (DSI-057) urged BPA to retain interruptible rights. The Washington State

Labor Council, AFL-CIO (DSI-059) comments supported the aluminum industry providing curtailment rights to BPA during periods of severe drought to prevent negative impacts to consumers or threatened fish species and that BPA should provide compensation to the aluminum industry during such curtailments to offset curtailment costs of affected employees, local taxing authorities and to the aluminum companies.

Evaluation and Decision

As described above, BPA will not provide physical power under a contract unless it can completely hedge all risk associated with the cost of that service to the capped amount allocated to the company. Catastrophic insurance is not needed to mitigate the risk Alcoa is describing. Nevertheless, under the option where BPA is serving the load with physical power and market prices are projected to be well above the cost to BPA of serving the load, curtailing a company's operations and remarketing the power may be in the economic best interest of BPA, the company and its employees, and other customers. In the event that BPA opts to provide physically delivered power instead of its financial equivalent, then BPA will require some type of long-term interruption right in the power sales contracts. The terms and conditions of such a right will be developed at the time of contract negotiations. Terms that will need to be negotiated include at what market price the interruption can be triggered, the amount subject to interruption, the length of the interruption, and the amount of reimbursement BPA will provide the DSI for the interruption.

Finally, a few parties suggested that BPA should require the DSIs to agree not to seek service from BPA after FY2011 in exchange for service from BPA in the FY2007-2011 period. BPA service to all its customers post-2011 is the subject of an upcoming regional public process. BPA limited the current Regional Dialogue to service issues in the FY2007-2011 period and, with the exception of the few comments calling for the DSI commitment regarding post-2011 service, parties have not addressed the long-term service issue. BPA wants to hear from all its customers and other interested parties, including the DSIs, regarding continued service by BPA to DSI load post-2011, and so will not condition a service offer for the FY2007-2011 period on a commitment from the DSIs regarding service post-2011.

IX. Decision Summary

Issue 1 – Level of Benefits:

BPA will offer the DSI aluminum smelters 560 aMW of service benefits for the FY2007-2011 period at a capped cost of $59 million per year. BPA will offer Port Townsend Paper Company 17 aMW of service benefits through its local utility at a rate approximately equivalent to, but in no case lower than, the PF rate. BPA will review its decision to supply 560 aMW of benefits at a $59 million capped cost to the aluminum companies for FY2007-2011 after the cost impact of the June 10, 2005, injunction becomes more clear and before final contracts with the DSIs are signed. A decision to reduce the amount of service benefits BPA will provide to the aluminum companies, up to and including a decision not to serve any aluminum smelter load, is possible.

Issue 2 – Eligibility and Allocation:

Of the 560 aMW in service benefits to be provided to the DSI aluminum companies, 320 aMW will be offered to Alcoa, 140 aMW will be offered to CFAC, and 100 aMW will be offered

to GNA. The contracts with the companies will provide for the permanent reallocation of unused benefits to other companies, but no company will be allocated an amount of average annual megawatts above its current contract amount. BPA will execute a power sales contract with a company only if it is creditworthy or provides credit assurances acceptable to BPA.

Issue 3 – Deliver Mechanism:

BPA will make 560 aMW of benefits available for the aluminum smelters and 17 aMW for Port Townsend. This will be accomplished through a secondary surplus power sales contract priced in a manner that, when monetized relative to expected market value, will result in an equivalent financial value of up to $12/MWh for the smelters. This will be the default mechanism for delivery of service benefits to the aluminum companies 2007-2011. The contract will contain a right for BPA to provide physically delivered surplus power in lieu of the financial transaction, if BPA determines it can completely remove all risk associated with market power purchases to serve the contract load at or below the $59 million annual cap. The sales will be made under BPA's surplus rate schedule. BPA will attempt to structure any physically delivered surplus power sale, or its financial equivalent, through the local utility whose service territory includes a smelter to be served.

Issue 4 – Credit Support:

BPA will not pursue credit support at this time.

Issue 5 – Other Issues:

If BPA exercises its option to make physical power deliveries under a contract BPA will require some type of long-term interruption rights. BPA will not condition a service offer for the FY2007-2011 period on a commitment from the DSIs regarding service post-2011.

X. Environmental Compliance

This section of this ROD provides an evaluation of the proposed DSI service for FY 2007-2011 under the National Environmental Policy Act (NEPA), 42 U.S.C. § 4321 et seq. The potential environmental effects that could result from BPA providing service to its DSI customers were evaluated in BPA's Business Plan Environmental Impact Statement (EIS) (DOE/EIS-0183, June 1995).

The Business Plan EIS was prepared in response to a need for an adaptive business policy that would allow BPA to be more responsive to the evolving and increasingly competitive wholesale electricity market, while still meeting both its business and public service missions. BPA's Business Plan EIS evaluates six alternative business directions: Status Quo (No Action); BPA Influence; Market-Driven; Maximize Financial Returns; Minimal BPA; and Short-Term Marketing. Each of the six alternatives provides policy direction for deciding 19 major policy issues that fall into five broad categories: Products and Services, Rates, Energy Resources, Transmission, and Fish and Wildlife Administration. Business Plan EIS, section 2.4.

Policy options, or modules, were also developed in the EIS to allow variations of the alternatives in four key areas, including DSI service. Business Plan EIS, section 2.1.2. The DSI

modules in the Business Plan EIS include Renew Existing Firm Contracts, Firm Service in Spring Only, Declining Firm Service, and No New Firm Power Sales Contracts. The EIS thus contains analyses of policy modules that consider service to the DSIs ranging from no new contracts to 100-percent firm service. (Business Plan EIS, sections 2.3.1.3 and 2.6.3.3.)

On August 15, 1995, the BPA Administrator issued a Record of Decision (Business Plan ROD) that adopted the Market-Driven alternative from the Business Plan EIS. This alternative was chosen because it more consistently meets the need and purposes identified in the Business Plan EIS than the other alternatives, and best strikes a balance among marketing needs, statutory obligations, and environmental concerns. This alternative also assists BPA in maintaining the financial strength necessary to continue BPA's support for public service benefits. Business Plan ROD, section 6. Although the Declining Firm Service DSI module is intrinsic to the Market-Driven alternative, the other DSI modules are identified as variable elements for this alternative as well. Business Plan EIS, section 2.3.2.

The Business Plan ROD also documented a decision strategy for tiering subsequent business decisions to the Business Plan ROD. (Business Plan EIS, section 1.4; Business Plan ROD, section 8.) For each such decision, as appropriate, the BPA administrator reviews the Business Plan EIS and ROD to determine whether the proposed subsequent decision falls within the scope of the Market-Driven Alternative evaluated in the EIS and adopted in the ROD. If the action is found to be within the scope of this alternative, the administrator may tier the decision for a proposed action to the Business Plan ROD. Business Plan EIS, section 1.4. BPA's NEPA ROD for its Policy for Power Supply Role for Fiscal Years 2007-2011 (Regional Dialogue), issued on February 4, 2005, is such a tiered ROD.

Recognizing the importance of the DSIs to the Pacific Northwest economy, the administrator's ROD for Regional Dialogue documented the policy decision that BPA would provide eligible Pacific Northwest DSIs some level of Federal power service benefits, at a known but limited quantity and capped cost, in the FY 2007-2011 period. Specific details were to be worked out in a supplemental regional public process. (Regional Dialogue NEPA ROD, page 8.) The NEPA ROD for Regional Dialogue also noted that, whatever level of DSI service was decided, the analysis of the environmental impacts would likely fall within the scope of the Business Plan EIS given the broad range of potential DSI service that was covered by the EIS. (Regional Dialogue NEPA ROD, page 13.)

Based on a review of the Business Plan EIS and ROD, I have determined that BPA's Service to Direct Service Industrial Customers for Fiscal Years 2007-2011 falls within the scope of the Market-Driven alternative evaluated in the Business Plan EIS and adopted in the Business Plan ROD. This service is a direct application of the Market-Driven alternative because it continues the implementation of the module that was intrinsic to the Market-Driven alternative. (Business Plan EIS, section 2.2.3.) Furthermore, since the proposed level of DSI operation is within the range of levels analyzed in the Business Plan EIS, it is not expected to result in significantly different environmental impacts from those examined in the EIS. I therefore have determined that it is appropriated to tier the decision to implement service to BPA's DSI customers for FY 2007-2011 to the Business Plan ROD.

This ROD, which satisfies BPA's requirements under NEPA, will be distributed to interested and affected persons and agencies. The ROD will also be posted on BPA's Web site for the Regional Dialogue, which is www.bpa.gov/power/regionaldialogue. Copies of the

Business Plan, Business Plan EIS, the Business Plan ROD, and Regional Dialogue ROD and additional copies of this ROD are all available from BPA's Public Information Center, P.O. Box 12999, Portland, Oregon 97212. Copies of these documents may also be obtained by using BPA's nationwide toll-free document request line, 1-800-622-4520.

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