

## BPA AND THE PUNCH BOWL



**Think of the Bonneville Power Administration as a “punch bowl.”**

That’s the best way to understand how BPA, a federal power marketing agency, operates.

“Bonneville is the punch bowl with every customer and other interest group with their straws,” BPA Administrator Randy Hardy explained to a Congressional subcommittee in 1993. “He or she

who has the biggest straw and sucks the hardest and the fastest gets the mostest.”<sup>1</sup>

Sixteen years later, the punch bowl is still the best way of describing how BPA works. Little has changed. If you want to get BPA’s attention, hire a lobbyist or get a member of Congress to write BPA on your behalf. Think political because the current administrator, Stephen Wright, responds to political pressure. Although he is a veteran federal employee who has spent his entire career at BPA – he understands the intricacies of the political process very well. Push hard and he may give you a bigger straw.

### **BPA and the DSIs**

In this newsletter, we explore BPA’s relationship with a group of energy-intensive companies called the Direct Service Industries (“DSIs”), primarily aluminum smelters.

BPA’s relationship with the DSIs is unique. In recent years, BPA has treated the DSIs as a special class of customers, as if they were entitled to a big straw, even when BPA was no longer obligated by law to serve them.

### **In this Issue:**

**We examine BPA’s relationship with the Direct Service Industries**

**What’s wrong with the proposed Alcoa contract**  
*Page 2*

**Big Burly Sailors**  
*Page 5*

**The \$32 million gift**  
*Page 8*

*BPA Watch Newsletter is a periodic publication designed to inform the public, the press and members of Congress about important issues concerning the Bonneville Power Administration. Copyright (2009), Columbia Research Corp.*

**Learn More –**  
**Visit our Web site at**  
**[bpawatch.com](http://bpawatch.com)**



Aluminum worker in the 1940's. Photo courtesy of BPA.

Once upon a time, BPA and the DSIs genuinely needed each other. In the 1940s, for example, the DSIs were BPA's largest customer group and produced aluminum essential for the war effort. And for many years after, BPA could cite with justification the value the DSIs provided to the federal power system: the stable revenues; the consistent (around the clock) use of BPA power; the ability of BPA to curtail smelter operations in certain conditions; and other tangible benefits. Simply put, the DSIs added value, and BPA tried to keep them happy.

Sometimes, BPA would provide favors and simultaneously threaten the DSIs: "this is the last time, next time we won't do it." Then, a few years later, the cycle would repeat itself. The DSIs would ask for a special deal and BPA would say, "ok, this time we'll do it, but no more."<sup>2</sup>

Despite BPA's efforts, few DSIs remain in operation today. International competition, volatile changes in the price of aluminum, the cost of operating old smelters, environmental constraints and rising power prices have all taken their toll.

The largest DSI left standing in the Pacific Northwest is Alcoa – the

Aluminum Company of America – which owns a smelter in Ferndale, Washington, near the Canadian border.<sup>3</sup>

Alcoa is quite open about it wants: cheap federal power. The company acknowledges it cannot make it on its own. Without BPA help, it will likely close.<sup>4</sup>

### Alcoa needs BPA's help to survive.

In various letters to BPA, Alcoa argues it is one of the agency's oldest customers and has contributed "substantial equity" in the federal power system – money it paid in rates over the last 70 years.<sup>5</sup>

BPA Administrator Wright has responded to Alcoa's pleas: he has publicly said he wants to keep the Ferndale smelter in operation.

BPA, however, has already lost two recent legal challenges involving an Alcoa contract.<sup>6</sup> Its legal options appear limited. Nonetheless, Wright appears to be on a personal mission to sign a new, seven-year, subsidized contract starting on October 1, 2009, to supply power to the Ferndale smelter and hopefully preserve 500 jobs there.

If preserving jobs at the smelter were the *only* criteria, no matter what, then BPA would be wise to proceed quickly (and the courts would likely approve). But BPA has no more cheap power to sell. That means BPA has to go out on the market and buy it. Alcoa can't afford to pay for market-priced power.

So BPA will shift the costs -- reaching \$400 million -- to public power utility customers in the region. And those utilities, in turn, will pass on BPA's costs of serving Alcoa to *their* retail consumers during one of the worst recessions since the 1930s. That means consumers in Everett, Seattle, Tacoma, Chehalis and Vancouver – to mention places in the I-5 corridor – will pay more on their monthly power bills to help out Alcoa. So will consumers in Ephrata and Wenatchee. And in Salem and Eugene and Newport, Oregon, and in parts of Idaho, too. That's the problem with the proposed Alcoa contract.

Furthermore, some of BPA's prior efforts to help the DSIs inadvertently *sacrificed* the workers. In 2001, for example, BPA paid \$226 million to a firm that was supposed to retain jobs and retrofit an aging aluminum smelter in Longview, Washington. The company took BPA's money and laid off 925 workers. And what did BPA do? Nothing. Click [here](#) to read the complete **BPA Watch** story of BPA and Longview Aluminum. What is to prevent the same thing from happening again?

Finally, we note that BPA proposes to protect Alcoa if BPA loses again in federal court. If that happens, BPA will waive any remedy it may have to seek restitution from Alcoa. In other words, Alcoa "wins" no matter how the court rules.

This is not a healthy situation. It is one thing to have a federal agency that dispenses benefits from a punch bowl according to what the law prescribes, but quite another situation if the BPA



administrator believes he can – and has a right to – disburse federal benefits without interference from Washington, D.C., or the courts.

In theory, Administrator Wright is constrained by federal law which gives him only limited authority to decide “who gets what” from the federal power system. But Wright, who has held the job for almost nine years, has stretched his powers beyond anything contemplated by Congress. Wright’s expansive view of his job appears unprecedented. During a recent BPA rate case (an administrative hearing), he snapped at lawyers who said things he did not like and threatened that he might – once again – attempt to resolve an important issue in private talks.<sup>7</sup>

Before we provide details about BPA and the DSIs, here is some background information about BPA and its mission.

### BPA’s Duties

BPA, with headquarters in Portland, Oregon, is part of the U.S. Department of Energy. Its primary duty is to sell and deliver power from 31 federal dams, one nuclear power plant and other sources. Most of the large federal dams are on the Columbia River and its tributaries.<sup>8</sup>

To deliver this electricity, BPA owns 15,000 miles of high-voltage transmission lines. The lines are like a publicly-owned railroad for electrons, owned by the federal government, with BPA as its manager.

BPA power is cheap, which is why electric utilities and other companies

<b>The DSIs in the Pacific Northwest in 1980</b>			
<b>Location:</b>	<b>Original Owner:</b>	<b>Type of Facility:</b>	<b>Date of BPA Service:</b>
Vancouver, WA.	Alcoa	Smelter	1940
Portland OR.	Pacific Carbide	Calcium carbide	1940
Pt. Townsend, WA.	Crown Zell.	Pulp/paper	1940
Longview, WA.	Reynolds	Smelter	1941
Mead, WA.	U.S. Govt.	Smelter	1942
Trentwood, WA.	Kaiser	Rolling mill	1942
Portland, OR.	Union Carbide	Ferro manganese	1942
Troutdale, OR.	U.S. Govt.	Smelter	1942
Tacoma, WA.	U.S. Govt.	Smelter	1943
Trentwood, WA.	U.S. Govt.	Smelter	1943
Portland, OR.	Pennwalt	Chlorine	1947
Vancouver, WA.	Carborundum	Silicon carbide	1949
Silver Bow, MT.	Stauffer	Phosphorous	1951
Wenatchee, WA.	Alcoa	Smelter	1952
Riddle, OR.	Hanna	Ferro nickel	1954
Columbia Falls, MT.	Anaconda	Smelter	1955
Albany, OR.	Oremet	Titanium	1956
The Dalles, OR.	Harvey	Smelter	1958
Bellingham, WA.	G-P	Chlorine	1965
<b>Ferndale, WA,</b>	<b>Intalco (now Alcoa)</b>	<b>Smelter</b>	<b>1966</b>
Goldendale, WA.	Harvey	Smelter	1971
Addy, WA.	Alcoa	Magnesium	1976

Source: BPA



want to buy it. These utilities, in turn, pass on the benefits of the federal power system to 12.5 million people in Washington, Oregon, Idaho and western Montana.

## Who has the Straws?

Not all the straws in BPA's punch bowl are supposed to be equal in size. BPA has three classes of customers, each with different legal rights:

- Public agencies and rural electric cooperatives, commonly called “public power” utilities or “preference customers.” Since 1937, these consumer-owned utilities have had first access to cheap BPA power.<sup>9</sup> They are non-profit entities. By law, they are supposed to have the biggest straw. BPA currently serves 127 of these utilities.
- Investor-owned utilities (“private power” companies). Most of these for-profit companies are traded on the New York Stock Exchange. Under the Northwest Power Act, BPA is obligated to pay them cash for their residential and small-farm customers. The utilities pass on those benefits to their customers, who receive a credit on their monthly power bills. The purpose of the program is to help equalize retail rates in the region.<sup>10</sup>
- The Direct Service Industries. Between 1981 and 2001, BPA was obligated by law to supply these companies. Since 2001, however, BPA can serve the DSIs if it wants but is under no legal obligation to do so.<sup>11</sup>

The DSIs are therefore unique among BPA's three classes of customers because they have – at least now – the fewest legal rights. In theory, they should have the smallest straw – if they have a straw at all.

**BPA's mission is to distribute power widely.**

We begin our narrative in the 1930s and end with BPA's current efforts to aid Alcoa.

## The Industrial Vision

The first request for federal power from an industrial user came in 1935, when Bonneville Dam, 40 miles east of Portland, was still under construction and before Congress had even created the Bonneville Power Administration.

It was not Alcoa, the dominant firm in the industry, which made the request but the Bohn Aluminum and Brass Corp., based in Detroit, which wanted to buy the dam's entire power output. Bohn said it planned to build a new industrial city near Portland for 5,000 workers plus a dozen industrial laboratories. Portland officials welcomed Bohn's proposal.<sup>12</sup>

But President Franklin Roosevelt had other ideas – he was committed to spreading the power benefits in the Pacific Northwest widely, to as many people as possible. Rural electrification was one of his top goals.

The Bonneville Project Act of 1937, which created BPA, reflected the Roosevelt Administration's ambitious priorities. In order to “encourage the widest possible use of all electric energy” and “to prevent the monopolization ...by limited groups,” the BPA administrator is “authorized and directed to ...construct, operate, maintain...electric transmission lines...,” the statute said.<sup>13</sup>

By then, the Bohn Corp. had abandoned its proposal. But the company's attempts to capture the output of Bonneville Dam only for itself had inspired Congress and the Roosevelt Administration to adopt a different vision -- a more populist notion of “who gets the benefits” from federal assets. In response, BPA set out to extend transmission lines to small communities in both Washington and Oregon, to create a federal power grid and distribute power as widely as possible.<sup>14</sup>

## Alcoa Comes to the Northwest

In 1940, Alcoa built the first aluminum smelter in the region. The location: Vancouver, Washington, on the edge of the Columbia River, north of Portland. Alcoa bought all of its power from BPA. The next year, another company, Reynolds, built a smelter in Longview, Washington. Others followed.

During World War II, a federal corporation, the Defense Plants Corp., constructed four aluminum smelters in Washington to supply essential materials for planes and other military purposes.<sup>15</sup> Two-thirds of BPA's power – which then included electricity



generated at Grand Coulee Dam in Washington – went to the smelters.

After the war, the federal government sold its smelters to private industry, but those companies did not build their own power plants. Instead, they turned to BPA for their supply.

Starting in 1948, however, the relationship between BPA and the DSIs changed. BPA agreed to supply only three-quarters of the DSI needs with firm (assured) power and one-quarter with surplus supplies.

In addition, BPA insisted on curtailing the DSIs under certain conditions – and only for brief periods of time – to provide operating reserves. BPA wanted the ability to interrupt the smelters if there was a malfunction or outage on the power system. (Aluminum smelters can withstand short-term interruption of power better than most industries.)

If the DSIs had not existed, BPA would have had to acquire rights to use a stand-by power plant, which would have probably remained idle for months on end, a back-up source in case of emergency. That was an expensive alternative. Retaining the rights to interrupt the DSIs was – in BPA's view – a cheaper and more efficient option.

The next decades saw more growth in the region – and more demand for power. BPA could not keep up. The sites for new dams were taken; the region had tapped the hydropower potential of the Columbia River and its tributaries.

Furthermore, the Hydro-Thermal Power Program, a joint BPA-utility-DSI construction effort to build coal and nuclear power plants, found itself in trouble in the 1970s.<sup>16</sup> Few of those power plants were ever finished. Some fell victim to the nascent environmental movement. Cost overruns and mismanagement doomed others, such as the nuclear plants being built by the Washington Public Power Supply System (“WPPSS”).<sup>17</sup>

**In 1980, the DSIs produced 40% of the nation's aluminum.**

BPA feared it would face a power shortage – a fear shared in the utility community.<sup>18</sup> The solution was the Northwest Power Act of 1980. To this day, the law remains the most important federal statute describing BPA's duties and obligations.<sup>19</sup>

## **The Act and the DSIs**

The primary purpose of the Northwest Power Act was to assure a stable supply of power for the region. Among its many provisions was one that gave BPA broad, new authority to buy electricity from new power plants.<sup>20</sup>

The DSIs regarded the legislation as a savior. If it did not pass, BPA would no longer supply them, as it had in the past. To pressure Congress to approve the legislation, the DSIs used a combination of veiled threats and offers of regional consensus.

“The DSIs are like big, burly sailors seated in the middle of an overcrowded regional lifeboat,” explained one DSI lobbyist to a Congressional subcommittee. “If they sit still, pull on the oars, and do as they are told – providing greater power reserves or paying higher power rates, as this legislation directs – they can help stabilize a precarious situation. But if the regional lifeboat is rocked too violently, everyone – including the DSIs – will scramble for the safest position.”<sup>21</sup>

In truth, there were not too many “safe” positions for the DSIs at the time. BPA had no statutory obligation to serve them. It was institutional momentum – the long history of their relationship with BPA and their contribution to the economy, which drove the DSI debate. In those days, the companies produced 40% of the nation's aluminum and contributed roughly one-third of BPA's annual revenue. They employed 13,400 people and their plants had a total payroll of about \$286 million. Those were numbers that mattered.<sup>22</sup>

*Without* BPA help, the DSIs would have had to buy power on the open market or build their own power plants.<sup>23</sup>

On the other hand, *with* BPA's new authority under the Northwest Power Act to buy electricity, BPA would have enough power to supply the DSIs. BPA could buy power and mix those purchases with the low-cost supply from the existing federal network of dams.<sup>24</sup> The DSIs (and the utilities, too) would obtain a stable power supply. The DSIs would pay much higher prices than they were used to



paying -- but less than they would pay without the Act.<sup>25</sup>

The final version of the legislation reflected this compromise. BPA was required to sign “initial” long-term contracts with the DSIs.<sup>26</sup> Those agreements lasted until 2001. After that date, however, BPA’s service to the smelters was discretionary.

### **BPA offered the DSIs special deals.**

To obtain this initial allocation of BPA power, the DSIs made several concessions: they gave BPA the right to interrupt even more of their power supply under certain conditions.<sup>27</sup>

In the past, BPA could curtail the smelters in the unlikely event of a power outage on the federal grid. In the new contracts, BPA said it had the legal right to interrupt a portion of the DSI supplies if power plants were never finished or if they operated poorly. These planning reserves, as they were called, were an essential part of the bargain that made up the Northwest Power Act. In theory, this part of the DSI contract allowed BPA to curtail a quarter (called the “second quartile”) of the smelters’ supply for weeks, perhaps even months, on end.<sup>28</sup>

“The legislative history of the Regional Act [the Northwest Power Act] makes clear that Congress expressly endorsed, perhaps even required, that the new contracts contain the conditions making the second quartile power more interruptible than before,”

the U.S. Supreme Court noted in a 1984 decision upholding the validity of the BPA-DSI contracts.<sup>29</sup>

By the late 1980s, however, BPA had concluded that the new planning reserves were all but worthless.<sup>30</sup> BPA never exercised this provision even though the WPPSS nuclear power plants had fallen years behind schedule and another nuclear power plant, Trojan in Oregon, operated at less than expected performance. BPA had not delivered on its promise to obtain greater interruption rights from the DSIs. And it was not the DSIs who were to blame. BPA’s own contracts, so awkwardly written, inhibited the agency from meeting its goal.<sup>31</sup>

### **The Billion Dollar Sentence**

The mid-1990s brought more unpredictable changes. Wholesale power prices plummeted. BPA found itself in an unpleasant situation. Competitors were offering better deals, and many DSIs wanted the freedom to “shop around.”

In the past, BPA had responded to DSI requests for special treatment. In 1983, for instance, BPA sold cheap surplus power to the DSIs in what was known as a “fire sale.”<sup>32</sup> But after the fire sale ended, the DSIs complained they could not afford BPA power. In response, BPA adopted a variable DSI rate in 1986 tied to the international price of aluminum.<sup>33</sup> When aluminum prices rose (and the DSIs presumably were making more money), BPA would raise power rates. When aluminum prices dropped, BPA dropped its power rates, too. Under the old BPA rate, the

DSIs had borne the risks of fluctuating aluminum prices. For 10 years, BPA assumed that responsibility as a way of keeping the DSIs in business.<sup>34</sup> But the variable rate expired in 1996.

So when power prices dropped -- yet again -- BPA responded, yet again. BPA offered the DSIs a cut-rate deal with an attractive power rate spelled out in a new contract that lasted until 2001.<sup>35</sup>

BPA was in something of a state of panic – it was concerned the DSIs would abandon it, leaving BPA with large amounts of surplus power and a huge hole in its revenue stream.<sup>36</sup>

But there was a catch. BPA insisted the DSIs agree to pay for this power no matter what – or pay a penalty. If a DSI decided for whatever reason *not* to operate its plant, it could do one of two things:

- Option 1. Pay a penalty to BPA. The DSI could curtail power purchases by paying a fee for *not* buying the amount it said it would; or
- Option 2. Pay BPA the full amount owed but allow BPA to remarket the power and share the benefits (from the sale of surplus federal power) with the DSI. If a DSI chose this option, BPA said it would bill the company for its full obligation (as if the plant were in operation) but would give the DSI a credit on its power bill for any excess revenue BPA obtained by re-selling the power.

Half of the DSIs chose the second option – a decision worth hundreds of millions of dollars, though a reader



of BPA's press releases and other documents could not have anticipated that outcome.

The reason: BPA inaccurately described its own agreements.<sup>37</sup> In various reports, BPA summarized the new contract terms for the DSIs this way: Suppose a DSI was obligated to pay \$1 million to BPA for power per month. If the DSI temporarily closed its doors (for whatever reason, including low aluminum prices), and if BPA could remarket (resell) the unused power for \$2 million, then BPA would give the DSI a credit of \$1 million on its future power bill.

### Some DSIs made money during the energy crisis.

BPA later repeated this description in legal briefs filed in the Ninth Circuit, where the DSI contracts were challenged by an association of retail industrial customers.<sup>38</sup> BPA told the court this section simply created a mechanism by which BPA would remarket power and would credit the DSIs in the future once they started their plants operating again.<sup>39</sup>

And based on BPA's description of the contracts, the court upheld this part of the BPA-DSI agreements in 1997.<sup>40</sup>

The truth about the contracts came out a few years later, during the West Coast energy crisis of 2000 and 2001. The dysfunctional California experiment in utility de-regulation was largely to blame for the sudden power shortage and accompanying price spikes. In addition, a severe drought

in the Pacific Northwest reduced the amount of power that BPA could sell from federal dams. Those were difficult times for BPA.

### Take the Money and Run

For those DSIs that had selected the remarketing (second) option in 1995, there was good news amidst the chaos. They could exercise their rights to have BPA remarket their allocation of federal power.

But the DSI contracts did more than require BPA to remarket this power and give them a credit on future power bills. The actual language -- a single sentence worth about \$1 billion to the companies -- required BPA to resell the power and pay them *cash*.<sup>41</sup>

If the DSIs only received a credit on future power bills, as BPA had originally maintained, the companies could take advantage of this benefit only if they stayed in business and bought BPA power. With cash, however, they could "take the money and run." BPA had to pay them money, and the DSIs no longer had an obligation to continue operating their smelters.

And that is what several companies did. Kaiser, for example, which operated a smelter in Spokane, Washington, took the cash and shut its smelter there. "We're making serious revenue," Kaiser vice president Pete Forsyth explained to the *Seattle Post-Intelligencer*.<sup>42</sup>

There was an irony here: Kaiser and some of the DSIs had successfully used BPA's benevolence (or perhaps

its incompetence) in drafting contracts to do the one thing that BPA had worked hard for decades to avoid: many DSIs went out of business for good.

### Longview Story

Only months later, BPA offered yet another special deal to a company, this one to a thinly-capitalized firm called Longview Aluminum.

### BPA gave Longview Aluminum a big straw.

In a prior newsletter, *BPA Watch* as documented the strange story of Longview Aluminum, and we only summarize the essential facts here.

Many of BPA's important deals for the DSIs in the past -- the "fire sale" in the 1980s and the variable industrial rate, for instance -- were arguably necessary to keep the companies going and stabilize BPA revenues. Reasonable people could disagree about BPA's priorities. And BPA deflected many of those criticisms by saying the companies were old customers who provided value to the federal power system. There was some truth in those assertions.

The tale of Longview Aluminum was different. There was an aura of favoritism and questionable management on BPA's part from the beginning. BPA Administrator Wright, in the job for only a few months, seemed bent in 2001 on giving the company a very big straw.

Longview Aluminum was a new entrant into the Pacific Northwest. The



company, owned by a group of Illinois businessmen who hired lobbyists to advance their cause, wanted to buy an aging, operating smelter in Longview, Washington.<sup>43</sup> Company officials said they wanted to convert the facility into a modern efficient operation that would make a new special alloy for commercial planes – an alloy that would do away with the use of rivets in manufacturing.<sup>44</sup> Among those who were retained to aid the company: former BPA Administrator Randy Hardy, then in private practice as a consultant.<sup>45</sup>

But Longview Aluminum had no money to buy the smelter from its owner, Alcoa.

So the company asked BPA to serve as its “bank.” With \$226 million from BPA, Longview Aluminum promised to: use BPA’s cash to buy the smelter from Alcoa; refurbish and modernize the plant; retain the work force during the closure; and restart the facility.

BPA paid the money in installments to Longview Aluminum, as promised, even though it had never even obtained a financial statement from the firm.

Unfortunately, Longview Aluminum did not uphold its share of the bargain.

Instead, the company bought the smelter from Alcoa, closed the plant, laid off the workers and never produced a pound of aluminum again.<sup>46</sup> To this day, BPA has not explained what happened to the money that Longview Aluminum was supposed to spend on modernizing the smelter and preserving jobs.

### The \$32 Million “Gift”

We now come to the present – the saga of BPA and Alcoa.

These are rough times for Alcoa, the last large DSI left standing. The price for aluminum is down, again, and power prices in the market are up, again. So it understandable that Alcoa wants to keep buying cheap federal power from BPA.

Many of the 500 workers at the Ferndale smelter have written poignant letters to BPA, asking the agency to help keep the smelter operating: “This job is important to me and my family. It gives all us workers peace of mind to know that we will have a job for the next few years,” one e-mail to BPA said.

But BPA has no more cheap power to sell. It is spoken for by BPA’s preference customers (the public power utilities). When cheap power runs out, BPA has the authority to go to the market and buy electricity, but it’s expensive. This process is called “augmentation.” Congress, however, does not appropriate money to cover BPA’s costs. Rather, BPA is a “self-financing” agency – it recovers its expenses in rates paid by utilities around the region.

That means BPA’s costs of buying power for Alcoa gets shifted to BPA’s preference customers. In this business, there is no such thing as a free lunch.

Ironically, BPA adopted a major policy change in recent years *not* to augment the existing federal power system for preference customers. Instead, BPA proposed to charge them market-based rates if their power needs exceed the capability of the federal power system.

For Alcoa, in contrast, BPA is proposing to charge a power rate that leaves BPA with a revenue shortfall of between \$382 and \$412 million over seven years (the term of the contract). In other words, BPA will not receive enough money from Alcoa to cover its costs. BPA therefore proposes to shift these costs to preference customers, who will pay more to keep Alcoa in business.

BPA’s preference customers understandably do not want to pick up Alcoa’s tab. It’s not that they are hard-hearted. But many of these utilities have industrial or large commercial plants in their service territory that have shut down in the current recession or that have threatened to do so. Many residential customers have trouble paying their power bills. They are concerned about *their* jobs. Stand on a street corner in those areas – in Aberdeen, Grays Harbor County, Washington, for example – and ask people if they want to help Alcoa pay its BPA power bills. You’ll get an earful.

Keep in mind that under the Northwest Power Act, Alcoa and other DSIs *had*





a legal right to buy power for 20 years. But that right expired in 2001. Since then, BPA is authorized to sell power to Alcoa but is under no legal obligation to do so.

Put in simple terms, Alcoa once had a straw in the BPA punch bowl but BPA does not have to let Alcoa suck out anything now. BPA could say “no, your turn has passed. Others with a better legal right are ahead of you.”

That is not the approach BPA has taken. Twice now -- in 2008 and again in 2009 -- the U.S. Court of Appeals for the Ninth Circuit has ruled against BPA, pointing out the legal deficiency in BPA’s contracts to serve Alcoa’s Ferndale smelter and two small DSIs: a smelter owned by Columbia Falls Aluminum Co. (“CFAC”) in Montana, and a pulp and paper mill in Port Townsend, Washington.

**BPA gave Alcoa a \$32 million “gift,” the court said.**

At issue in the first court case was a legal challenge to BPA’s 2005 contract with these three companies. Alcoa was by far the largest beneficiary. The contract was unusual because BPA had decided to pay cash rather than sell power. Instead of receiving electrons from BPA, Alcoa received money every month. With this cash, Alcoa reduced its power bill from another supplier, a BPA competitor.

The problem with BPA’s approach is that it is not in the economic

development business. BPA is not free to pick and choose favored industries and bestow special deals on them at the expense of others.

Furthermore, the costs of BPA’s special deals for Alcoa are spread around the region, where millions of residential consumers and many industries, who are themselves facing a hard time, will then pay more on their monthly power bills. Small wonder, then, that these utilities and their industrial customers have sued BPA.

In December 2008, a federal court held BPA’s contract with Alcoa violated the Northwest Power Act.<sup>47</sup> The main issue before the U.S. Court of Appeals for the Ninth Circuit was technical: whether BPA could base its cash payments on a certain rate.

The court said no. BPA had used the wrong rate – a rate most favorable to Alcoa – in calculating the level of cash benefits.<sup>48</sup>

Although the court did not completely invalidate the BPA-Alcoa contract, its opinion described BPA’s obligation to act in a business-like manner and exercise “sound business judgment.”<sup>49</sup> The court said: “By subsidizing the DSIs’ smelter operations beyond what it is obligated to do, BPA is simply giving money away.”<sup>50</sup> The court then remanded the matter back to BPA for its consideration.

### **And what did BPA do?**

Over the Christmas-New Year’s holidays in 2008-2009, BPA drafted a temporary 10-month contract

amendment to pay \$32 million to Alcoa. Despite the importance of this amendment, BPA offered only three business days for interested parties to comment. BPA published no Record of Decision, as it normally does; BPA offered no explanation of why its decision was consistent with “sound business principles,” as the court said it should.<sup>51</sup>

When the case came back to the same panel of judges, BPA’s Office of General Counsel went so far as to argue there was no law to apply in evaluating the legality of BPA’s contract amendment. Once BPA had corrected the defective rate – that was it. BPA did not have to demonstrate it had acted according to sound business principles, its lawyers told the court. In BPA’s cavalier view of the world, the judges were powerless to act.

The three-judge panel clearly did not buy BPA’s argument. On August 28, 2009, the judges invalidated BPA’s 10-month contract amendment with Alcoa. BPA, the court said, had misunderstood its earlier opinion. The judges described BPA’s payments to Alcoa under the contract amendment as “no more than a \$32 million gift.”<sup>52</sup>

Has BPA learned its lesson? No, it does not appear so.

BPA is now proposing to sign a seven-year power sales agreement with Alcoa that will shift between \$382 - \$412 million in costs to preference customers. That amounts to \$55 - \$59 million per year.

If there is any doubt about where Administrator Wright’s priorities lie, it



is in keeping Alcoa happy, even if this means raising power rates for every preference customer in the region. BPA will likely sign the contract in late September 2009.

Why?

Look at the politics. Washington's two Democratic Senators (Murray and Cantwell) want the Alcoa smelter to remain operating. With a Democratic President and this type of political support, what do you think Administrator Wright would do?

Furthermore, Wright is seeking to immunize Alcoa from having to pay restitution if BPA loses another round of litigation. The offending section in the proposed BPA-Alcoa contract reads as follows:

*"In the event the Ninth Circuit Court of Appeals ...issues a final order that declares or renders this Agreement, or any part thereof, void or otherwise unenforceable, neither Party shall be entitled to any damages or restitution of any nature, in law or equity, from the other Party, and each Party hereby expressly waives any right to seek such damages or restitution. For the avoidance of doubt, the Parties agree this provision shall survive the termination of this Agreement, including any termination effected through any order described herein."*  
(Emphasis added.)

In plain English, this language means that even if the Ninth Circuit rules against BPA again – a third time – BPA cannot recover money or the value of power from Alcoa.<sup>53</sup> This section is

intended to live on, even if the rest of the contract is declared invalid. The section lingers, like the smile of the Cheshire cat in Lewis Carroll's *Alice in Wonderland*. The cat disappeared but the grin remained.<sup>54</sup>

If BPA proceeds with this contract term, as it seems eager to do, the preference customers will almost certainly challenge BPA's actions once again.

And once again, the court will address BPA's ability to dole out benefits from its punch bowl.

**END**

*The author, Daniel Seligman, is an attorney-at-law and publisher of **BPA Watch**. He has worked for public power utilities on DSI issues.*



## ENDNOTES

1. See statement of BPA Administrator Randy Hardy at a hearing of the House Committee on Small Business (Subcommittee on Regulation, Business Opportunities and Technology), held in Portland, Oregon, on June 3, 1993. Hardy made similar “BPA punch bowl” comments to the press. See, for example, *New York Times*, July 3, 1993 (“Bonneville, Citing Drought, Lifts Power Rate 15.6%”). Hardy’s description was not flattering, but in fairness to him, he offered the “punch bowl” analogy as a way of explaining why he wanted to reform BPA. He did not succeed.
2. In 1996, for instance, BPA signed a contract with several DSIs that prohibited them from asking for more federal power after 2006. See, for example, the contract language that BPA inserted into the agreement with Columbia Falls Aluminum Co. (“CFAC”), which owns a small smelter in Montana. The contract said: “CFAC agrees that it will not argue in any legal or political forum that it has a statutory right to or should be allocated, any direct or indirect service of Federal power after September 30, 2006.” The language soon proved useless. CFAC advocated for more power after 2006, and BPA acquiesced again.
3. Alcoa also owns a smelter in Wenatchee, Washington, but it depends largely on power from a local utility, the Chelan County Public Utility District, which owns dams on the Columbia River. Another smaller smelter in Montana is owned by a different company, the Columbia Falls Aluminum Co. It too wants to buy power from BPA. Finally, a pulp and paper company in Port Townsend, Washington, is a DSI. BPA proposes to serve it, too, but the amount of power (17 aMW) is a fraction of what Alcoa wants (340 aMW).
4. In March 2009, Alcoa said the smelter was at an “extreme risk” of closing unless BPA signed a new power sales contract. See *Bellingham Herald*, July 17, 2009 (“timeline of Ferndale-area smelter”). Alcoa repeated this statement in an August 9, 2009 letter to BPA. Without service from BPA, the Ferndale smelter’s power rates would increase from \$34.60 per megawatt hour (“MWh”) (the rate Alcoa would pay under the new contract) to \$58.50 per MWh (the rate Alcoa would pay for power from someone else). Without BPA’s contract, Alcoa would have no choice but to close the smelter and lose the jobs (500 direct and 1,500 indirect jobs). See letter to BPA from Mike F. Rousseau, plant manager of the Ferndale smelter.
5. See, for example, letter from Alcoa plant manager Mike F. Rousseau to BPA, dated August 9, 2009. The problem with the “equity” argument is that customers of an electric utility or federal power marketing agency (such as BPA) do not have “equity” in the system. They are customers, and their rights (e.g., to BPA power) depend on statute. The same principle is true of customers of a local utility. E.g., if a retail business in Seattle closes, it does not write Seattle City Light asking for money back for its prior “investment” made when it paid its power bill, nor can the company legally claim to have “equity” in the municipal electric system.
6. *PNGC v. DOE*, 550 F.3d. 846 (9<sup>th</sup> Cir. 2008), amended on denial of reh’g, 2009 WL 2386294 (August 5, 2009) (“*PNGC I*”). See, also, *PNGC v. DOE*, case no. 09-70228 (August 28, 2009) (“*PNGC II*”).
7. See transcript of BPA oral argument in the WP-10 and TR-10 rate case, June 10, 2009. The “private talks” that BPA Administrator Wright threatened related to the Residential Exchange Program (“REP”), not issues related to the DSIs. But Wright has tried for nine years to “settle” the level of REP payments that BPA makes to investor-owned utilities in the region for their residential and small-farm consumers. BPA has lost litigation on the subject in the Ninth Circuit – see **BPA Watch** newsletter no. 1 for



details -- and another round of private settlement talks is not likely at this point to lead to a regional solution. The reverse may be true: closing the door and keeping some parties out may lead to more litigation. The transcript provides other examples of Wright's testy responses to arguments made by lawyers. Two examples suffice here. **Example 1:** When a utility lawyer questioned BPA's reliance on computer models ("garbage in/garbage out," in her words), Wright questioned not only her legal arguments but her "motivations," which showed a "shocking display of lack of historical knowledge about how this [particular] rate evolved." Transcript at page 104.

**Example 2:** When a lawyer for a trade association of industrial customers (that represents Weyerhaeuser, Boeing and other companies) expressed concern about the level of BPA's rates, Wright took umbrage again. Wright asked the lawyer why BPA should work with the companies, "when, candidly, as a business partner, you don't come across as someone who worries about the things that we have to worry about, shares with us your problems and your interests, but really just don't show a lot of regard for the kind of issues we have to address here." Transcript at page 211.

8. BPA does not own the federal dams. Most of the federal dams in the Columbia River Basin are owned by the U.S. Army Corps

of Engineers. Others (such as Grand Coulee) are owned by the U.S. Bureau of Reclamation. BPA's responsibility, as a federal power marketing agency, is to "market" (e.g., sell and deliver) the power.

9. See section 4a of the Bonneville Project Act, which gives states that the Bonneville Project shall be operated for the benefit of the "general public," and "particularly of domestic and rural consumers." The administrator "shall at all times, in disposing of electric energy generated at said project, give preference and priority to public bodies and cooperatives." Section 3 defined public bodies to mean "States, public power districts, counties, and municipalities..."

10. Section 5c of the Northwest Power Act created the Residential Exchange Program. The investor-owned utilities do not make a profit on the program; they pass on the benefits directly to their residential and small farm customers.

11. The Northwest Power Act required BPA to sign "initial" power sales contracts with the DSIs. See section 5(d)(1)(B), which stated: "After December 5, 1980 [the date the Act was passed], the [BPA] Administrator shall offer...to each direct service industrial customer an initial long term contract...." See, also, section 5(g).

12. Richard Lowitt, *The New Deal and the West*, University of Oklahoma Press (1984), at page 162.

13. See section 2(b) of the Bonneville Project Act.

14. To facilitate the transmission of power over longer distances, BPA adopted "postage stamp" transmission rates.

15. The four government smelters were built at Mead, Washington and Trentwood, Washington (two "sister" plants near Spokane); Troutdale, Oregon; and Tacoma, Washington.

16. For a summary of the Hydro-Thermal Power Program, see the court's discussion in *Port of Astoria v. Hodel*, 595 F.2d 467 (9<sup>th</sup> Cir. 1979). See, also, *Sierra Club v. Hodel*, 544 F.2d 1036 (9<sup>th</sup> Cir. 1976). The litigation was triggered when BPA signed a power sales contract for a new smelter, originally proposed for Guemes Island, Washington. When the proposal drew opposition there, the plant owner moved the proposed site to Clatsop County, Oregon, and when environmental obstacles were raised there, the site was moved again to Umatilla County, Oregon.

17. WPPSS attempted to build five nuclear power plants. Only one plant, WNP-2 (now known as Columbia Generating Station), was ever finished.



18. BPA had given “notices of insufficiency” to its customers in stages. In 1973, BPA told the region’s investor-owned utilities it did not have enough power to offer them new contracts. In 1975, BPA gave a similar notice to the DSIs. In 1976, BPA told its preference customers it would not be able to satisfy all of their power needs after July 1, 1983. By 1979, the situation was even more dire in BPA’s view. “The region’s hydro resources are no longer sufficient to meet all the electric power needs of the region... The thermal [e.g., nuclear] plants [built by WPPSS]... are running...5 years or more behind construction schedules, leaving potential deficits of 2,000 to 4,000 average megawatts in any year of the 1980s when streamflows happen to dip near the lowest level of record.” See BPA’s Legislative History of the Northwest Power pat, page ii.
19. The full name of the statute is the Pacific Northwest Electric Power Planning and Conservation Act, 16 U.S.C. 839 et seq. The law is commonly referred to as the “Northwest Power Act” or “Regional Act.”
20. Prior to the Northwest Power Act, BPA had financed construction of portions or nuclear power plants through the use of a financial mechanism called “net billing.” BPA paid for the cost of the construction program and then deducted these expenses from the power bills of its utility customers. The gross bill minus the construction costs equaled the “net bill.” As the construction costs of the WPPSS plants rose, BPA exhausted its capacity to use “net billing.” The Northwest Power Act gave BPA authority to buy electricity from new sources (unconstrained by the mechanics of net billing).
21. Testimony of Eric Redman, DSI lawyer, to the House Committee on Interstate and Foreign Commerce, Subcommittee on Energy and Power, House Report No. 96-70, October 19, 1979.
22. See statement of Harry Helton, Northwest operations manager for Reynolds Metals Company, before the U.S. Senate Energy and Natural Resources Committee, Senate Report No. 96-28, May 23-24, 1979.
23. A third choice – going to their local utilities and asking them for power – was unrealistic. BPA had already said it would curtail both preference customers (public power) and investor-owned utilities. Asking those utilities for power would only exacerbate regional tensions by decentralizing the shortage problem, making individual utilities, some of them small, go out in the marketplace to buy electricity or build power plants. The DSIs and utilities wanted a regional solution.
24. In general, the power from federal dams was (is) the cheapest anywhere in the region and perhaps anywhere on the West Coast. But the supply was limited. Power from the alternatives was invariably more expensive. BPA at the time charged “melded” rates: it mixed its high-cost purchases with low-cost hydropower to shield customers from paying market prices.
25. As part of the regional compromise, the DSIs also agreed to pay for the costs of the Residential Exchange Program for five years – until July 1, 1985. See section 7c(1)(A) of the Northwest Power Act. At the same time, Congress prohibited BPA from serving new DSIs. See section 5(d)(2).
26. Section 5(d)(1)(B) of the Northwest Power Act.
27. DSI load was separated into “quartiles” (quarters). Each quarter of DSI load had its own operating and reserve requirements.
28. The Northwest Power Act defined “reserves” as the electric power needed to avert planning or operating shortages and which come from resources (e.g., power plants that were on standby) or from “rights to interrupt, curtail, or otherwise withdraw” portions of the electric power supplied to customers (e.g., DSIs). See section 3(17) of the Act.



29. *Aluminum Co. v. Central Lincoln Peoples' Util. District*, 467 U.S. 380, 393-393 (1984).
30. One of the ways to measure the efficacy of BPA's reserves is to examine its Value of Reserves study, which it prepared as part of the power rate case. In the 1985 VOR, for example, BPA estimated that the value of DSI reserves equaled approximately \$90 million. The vast majority of these benefits were associated with power outage reserves. The "planning reserves" were only valued at \$664,000, less than one tenth of one percent. See BPA Value of Reserves Study, part of the Wholesale Power Rate Design Study, WP-85-FS-BPA-08, at pages 115-129.
31. To exercise these planning (also called second quartile) reserves, BPA had to give advance notice to the DSIs, call for voluntary conservation and engage in other cumbersome requirements. In other words, the actual contract language inhibited BPA's use of these reserves – despite a description to the contrary in the U.S. Supreme Court's decision in *Aluminum Co. v. Central Lincoln*, cited above in note 29. The Court's description of the BPA-DSI contracts reflected what BPA and others told Congress would happen if it passed the Northwest Power Act.
32. *Portland General Electric v. Johnson*, 754 F.2d 1475 (9<sup>th</sup> Cir. 1985). BPA said it faced a projected surplus of firm power and insufficient revenues in 1983 to meet costs. Because of slack demand in aluminum, the DSIs had cut back. BPA's solution was to offer a special surplus firm power rate to the DSIs to encourage increased power consumption.
33. The Variable Industrial ("VI") rate reflected the recommendations contained a detailed BPA analysis, the BPA's "DSI Options" study of 1984, which identified how BPA might keep the smelters operating and enhance BPA revenues at the same time.
34. At the time, BPA had significant amounts of surplus power available to sell, and it was concerned in part with the financial ramifications to its revenue stream if many DSIs went out of business or reduced operations simultaneously. The goals of the VI rate were described in BPA's Record of Decision for the 1986 Variable Industrial Power Rate Proposal, VI-86-A-02 at page 27, and the 1986 Variable Industrial Power Rate Design Study, VI-86-FS-BPA-02 at page 49. BPA projected it would make \$1 billion more over the 10-year period when the VI rate was in effect, compared with the standard industrial power rate.
35. The "target price" was \$22.60 per MWh. BPA did not (and could not legally) guarantee it would meet that target, but BPA gave the DSIs a right to terminate the contract on only seven (7) days' notice if BPA failed to meet the target price. The process leading up to the signing of the five-year contracts was very contentious. Initially, Energy Secretary Hazel O'Leary refused to give permission to BPA to sign the agreements. Under pressure from Senators Mark Hatfield (R-OR.) and Slade Gorton (R-WA.), O'Leary reversed her decision and allowed BPA to sign the agreements.
36. See, BPA's Record of Decision (September 28, 1995) for the Block Sale Contracts. The ROD described the benefits that the DSIs provided to the regional power system. *Id.* at pages 3-5. Sudden loss of DSI loads (between 2,500 and 3,000 aMW) "could seriously affect BPA's ability to continue meeting its obligations to repay the U.S. Treasury." *Id.* at 5.
37. *Id.*
38. The industrial group was the Association of Public Agency Customers ("APAC"). Its members included major retail industrial users, such as Boeing and Weyerhaeuser, who purchased power from public agency (preference customers). They were concerned about the equity and rate issues of BPA's new contracts.



See pages 26-27 of BPA's brief dated July 3, 1996 submitted to the Ninth Circuit in the APAC petition, case no. 95-70927, consolidated with 95-70859. BPA told the Court: "Under section 18..., the DSIs may curtail their take of energy if they shut down production...BPA will remarket the power to another purchaser and **credit the company's bill for the resale price**....Section 18 does not give the DSIs the right to market energy. Instead...the DSIs may request that BPA remarket excess energy....The DSIs will be billed for their full obligation [the "take or pay" provisions in the agreement] but will receive a credit for any remarketing revenues less administrative costs...." (Emphasis added.)

39. *Id.*

40. *Ass'n of Public Agency Customers v. Bonneville Power*, 126 F.3d 1158 (9<sup>th</sup> Cir. 1997). The decision addressed a number of complex issues related to BPA's contracts with the DSIs. The legality of the re-marketing provision was a comparatively small minor issue in the petitioners' briefs and was only a small part of the court's opinion. *Id.* at 1178. As a general rule, BPA cannot allow private parties, such as the DSIs, to resell federal power to other wholesale customers. See section 5(a) of the Bonneville Project Act. "Contracts for the sale of electric energy to any private person or agency...shall

contain a provision forbidding such private purchaser to resell any of such electric energy... and requiring the immediate canceling of such contract in the event of violation of such provision." The "remarketing" provisions are therefore best understood as a way around this ban. BPA apparently believed that by allowing the DSIs to direct BPA to sell the power (rather than reselling it themselves), the Bonneville Project Act provisions would not be triggered. Whether a court would have upheld the remarketing provisions had it known that BPA would provide cash to the companies is not known.

41. The actual contract language in section 18(b)(4)(D) of the BPA-DSI contract stated: "BPA shall credit the Company's wholesale power bill for revenues from sales of Excess Firm Energy... If the amount of the credit during any month exceeds the power bill amount, **then BPA shall pay the company the difference.**" (Emphasis added.) This sentence required BPA to write a check, not just give a credit on the DSIs' power bill.

42. *Seattle Post-Intelligencer*, December 11, 2000.

43. Longview Aluminum and its sister company, McCook Metals, apparently hired two lobbying firms, O'Keefe, Ashenden, Lyons and Ward, as well as Patton Boggs, to assist in their efforts

to secure the BPA contract. See **BPA Watch** newsletter, vol. 2 (November 2007) at page 6 and footnote 18 for details.

44. *Id.* at page 4.

45. In its negotiations with BPA, Longview Aluminum and its sister company, McCook Metals, were represented by a number of consultants and lawyers, including former BPA Administrator Randy Hardy, who had left the agency and was then a consultant in private practice. The company also hired former BPA general counsel Harvard Spigal. The practice of hiring former BPA executives and managers to help negotiate contracts or otherwise participate in DSI business was not new and was, in fact, quite prevalent several decades ago. Several power managers at BPA left the agency to work for the DSIs. Two BPA administrators, H.R. Richmond (who retired in 1972) and James Jura (who retired in 1991), joined the boards of directors of DSIs within about a year of leaving BPA. In Richmond's case, it was Kaiser Aluminum and Chemical Corp. In Jura's case, the company was Columbia Aluminum.

46. See **BPA Watch** newsletter, vol. 2 (November 2007) at pages 7-11 for details.

47. *PNGC v. DOE*, 550 F.3d 846 (9<sup>th</sup> Cir. 2008), *amended on denial of reh'g*, 2009 WL 2386294 (Aug. 5, 2009) ("PNGC").

- 
48. *Id.* at 870-873.
49. *Id.* at 877-878.
50. *Id.* at 877.
51. BPA published a decision-making document two months later when it signed a similar agreement with the small Montana smelter owned by CFAC. But BPA had offered no justification for its action when it signed the Alcoa amendment.
52. *PNGC v. DOE*, case no. 09-70228 (August 28, 2009), at page 11988 (“*PNGC II*”).
53. Alcoa argues that it is giving up claims for damages against BPA totaling \$195 million and this agreement is therefore equitable. But it is difficult to understand the validity of these claims after the Ninth Circuit’s rulings in both *PNGC I* and *PNGC II*. Alcoa also argues it has rights to buy power because of its long-term historic relationship with BPA. But the Ninth Circuit found this argument unconvincing. See *PNGC II*, 550 F.3d at 875-878.
54. “...I wish you wouldn’t keep appearing and vanishing so suddenly; you make one quite giddy.’ [Alice told the Cat]. ‘All right,’ said the Cat, and this time, it vanished quite slowly, beginning with the end of the tail, and ending with the grin, which remained some time after the rest of it had gone. ‘Well! I’ve often seen a cat without a grin,’
- thought Alice, ‘but a grin without a cat! It’s the most curious thing I ever saw in all my life!’” Lewis Carroll, *Alice in Wonderland*, Quality Paperbacks (1994), at pages 88-89.