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September 11, 2002

***Via E-Mail***

Stephen J. Wright
Administrator and Chief Executive Officer
Bonneville Power Administration
P.O. Box 3621
Portland, OR 97208

Frank L. Cassidy, Jr.
Chairman
Northwest Power Planning Council
851 SW 6th Ave., Ste. 1100
Portland, OR 97204-1248

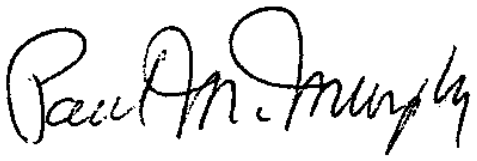
Re: Joint Comments of Alcoa Inc. and Golden Northwest Aluminum, Inc.
On BPA's Policies for Sale of Federal Power After 2006

Dear Mr. Wright and Mr. Cassidy:

Attached you will find a "Discussion Paper on BPA's Options For Post-2006 Policies on the Sale of Federal Power" dated September 12, 2002. This paper is submitted jointly on behalf of Alcoa Inc. and Golden Northwest Aluminum, Inc. in response to your letter and request for comments dated June 19, 2002. Please post these comments for public view and include them among the proposals and comments for public discussion in the "Regional Dialogue" you are currently conducting in this matter. Both Alcoa and Golden Northwest are also submitting additional comments or proposals under separate cover.

Thank you very much for your time and consideration in this matter.

Sincerely,



Paul M. Murphy

PMM
Attachment

**DISCUSSION PAPER ON BPA'S OPTIONS FOR POST-2006 POLICES ON THE SALE OF FEDERAL POWER**
**September 12, 2002**
**Alcoa Inc.**
**Golden Northwest Aluminum, Inc.**

On June 19, 2002, the Bonneville Power Administration (BPA) and the Northwest Power Planning Council (NWPPC) asked interested parties in the region to comment on how BPA should market power and distribute the costs and benefits of the Federal Columbia River Power System (FCRPS) in the Region after 2006. Alcoa Inc. and Golden Northwest Aluminum, Inc., both of which are also submitting individual comments, submit these comments jointly. BPA stated that it would apply five principles to evaluating suggestions submitted by stakeholders. Two of the principles are the focus of these comments: that the policy options not require legislative change and should minimize legal risk (*i.e.* they be within the letter and spirit of BPA's legislative authority); and that whatever option is selected, it should create clarity regarding BPA's load obligations after 2006.

## Executive Summary

### The Regional Act Makes Service to BPA's Three Customer Classes (Publics, IOU Residentials and DSIs) Mutually Interdependent

The Pacific Northwest Power Planning and Conservation Act (Regional Act), 16 U.S.C. § 839 *et. seq.*, was designed to provide all customers within the Pacific Northwest the ability to purchase Federal power from BPA. The expectation that all customers would obtain service from BPA was so embedded in the Act that the Residential Exchange program, the sole lawful means for BPA to provide wholesale rate parity for residential and small farm customers of investor-owned utilities (IOUs), cannot be made to work under the law unless BPA continues to serve its direct service industrial (DSI) customers. The reason that the Residential Exchange program is wholly dependent on service to the DSIs is that the Regional Act prohibits BPA from collecting from public agency customers the costs of the program.

- Early advocates of Federal development of the hydroelectric capabilities of the Columbia River System recognized that industrial sales were key to the financial success of the Federal hydro projects. The DSIs have been significant customers of BPA since its inception. Power sales to the DSIs allowed BPA to pay for the Federal Power system in a way that it could not have done without the DSIs. (Point I)

- BPA and the Federal electrical facilities have played a key role in the integrated power system for the Pacific Northwest by developing a regional transmission system and coordinated planning of Columbia River operations to carry out responsibilities under the Canadian Treaty. Service of DSIs by a regional BPA

instead of by local utilities contributed significantly to making the integrated system work. (Point II)

- The Regional Act was passed to alleviate barriers to planning and constructing an adequate, efficient, economical and reliable power supply for *all* loads in the Pacific Northwest, including the DSIs. (Point III)

- The Regional Act was intended to provide permanent solutions to several problems. (Point IV) The expected benefits of the Regional Act include:

  - To regionalize power planning and operations under a "one-utility" system to reduce overall power costs to the region;
  - To allow BPA to continue to serve DSI loads so as to enhance integrated operation of the system and avoid jeopardizing a nationally important industry;
  - To assure adequate federal resources to avoid the need to allocate a power deficiency among existing and new preference customers. The region realized that preference loads would increase dramatically without the Act through the creation of new preference customers out of IOU territory and DSIs seeking service from the local utility if BPA could not serve them and normal load growth;
  - To reduce the financing cost to customers of constructing and owing generating facilities, by BPA buying the output of such facilities and reselling the output at BPA's costs; and
  - To provide wholesale rate parity for residential and small farm consumers of IOU and preference customers through the "Residential Exchange" program.
    - The Regional Act has rate directives that make the promised wholesale rate parity completely dependent on BPA's power sales to DSIs.
    - BPA has no lawful means to effectuate wholesale rate parity if it chooses not to serve the DSIs.
    - Since wholesale rate parity for the IOUs' residential and small farm consumers is contingent upon continuing power sales to the DSIs, BPA must offer power for sale to the DSIs, and the DSIs must purchase, at the statutory rate as contemplated by the Regional Act if BPA intends to continue providing Residential Exchange benefits.

- Sound business principles require that BPA have adequate notice of its expected load serving obligations. BPA should exercise its broad contracting authority to require customers to provide adequate notice of the desire for service as a means to clarify BPA's load obligations in the future. (Point V)

- Under the Regional Act, BPA should be prepared to serve the full net requirements of all Regional utilities and of all DSIs when requested to do so. In order to balance its power supply with demand, BPA must demand multi-year notice of the intent to purchase and negotiate simultaneously power sales and resource acquisition contracts.

## I. The Historic Role of DSIs

The Bonneville Project Act, 16 U.S.C. § 832 *et seq.*, which created BPA as the agency to market the output from the Grand Coulee and Bonneville projects, authorized BPA broadly to sell power for resale or direct consumption to public bodies and cooperatives (preference customers), private agencies or persons, and Federal agencies. 16 U.S.C. § 832d(a). BPA was directed to set rates to encourage "the widest possible diversified use of electric energy" and "the equitable distribution of the electric energy developed at the Bonneville Project." 16 U.S.C. § 832e; *see also id.* § 832a(b).

President Roosevelt and his allies sought to ensure that BPA would "include extension of electric power to farms and homes, through public-power districts, as well as to big industry." Cong. Rec. H 4432 (May 12, 1937) (Rep. Pierce). Their primary interest was economic development, and they recognized that sales to industry were important in achieving such development. *See, e.g., id.* at 4433.

BPA was also directed to give preference and priority to public bodies and cooperatives (and to encourage their formation). 16 U.S.C. § 832c. Some have argued that this provision, known as the Preference Clause, somehow nullifies BPA's duty to serve other classes of BPA's customers, particularly DSI customers. But preference rights are important only when the supply of power is insufficient; they do not address BPA's underlying duties with respect to the adequacy of supply. As the Supreme Court has explained, "the preference system merely determines the priority of different customers when the Administrator receives 'conflicting or competing' applications for power that the Administrator is authorized to allocate administratively."[1]

The Project Act also empowered BPA to build transmission lines "[i]n order to encourage the widest possible use of all electric energy that can be generated and marketed and to provide reasonable outlets therefore, and to prevent the monopolization thereof by limited groups …." 16 U.S.C. § 832a(b). The Project Act's provisions were designed to prevent the monopolization of Federal power for resale by IOUs.[2] To further assure that Federal power would not be monopolized by IOUs, the Bonneville Project Act required that BPA retain, at all times, the right to cancel power sales contracts with IOUs upon five years notice if the power were needed to serve preference customer load. 16 U.S.C. § 832d(a).[3]

As a result of these provisions, and the infancy of the public-power market, BPA initially focused upon sales to the electrochemical industry. Congress also knew that industrial loads, with higher utilization factors, were essential to supporting the economics of the hydro projects. As one witness testified during hearings on the Bonneville Project Act:

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[1] *Aluminum Co. of America v. Central Lincoln People's Utility District*, 467 U.S. 380, 393 (1984).
[2] See generally "*Columbia River Power For the People, A History of the Policies of the Bonneville Power Administration*," ("*Columbia River Power*") pp. 69-72.
[3] BPA was not obligated to retain any such "recall" rights in contracts with its DSI customers.

> "Electrochemical and electrometallurgical industries operate at from 50 to 90% loads, while the domestic user takes his power at only 20 to 25% of the time. You have to have those industries using great blocks of power to carry the business. And, if they carry it, then your domestic user gets the full advantage of this great use; but if you have not those big users and are only handing the power out to farmers and domestic users, there is no power plant on earth that can do that and make a success …"[4]

Indeed, all of the early advocates of Federal development of the hydroelectric capabilities of the Columbia River system relied extensively on the symbiotic financial relationship between the Federal projects and private investment in large industries in the Pacific Northwest.[5] As BPA's general counsel summarized in 1940:

> "it was recognized by Congress that the vast amount of power produced by Bonneville Dam could not be consumed in the area in its present state of development and that marketing of the power must depend largely upon the growth of the region in population and industries."[6]

From 1940 to 1945, the number of BPA industrial and utility customers increased from five to eighty, and BPA's annual revenues increased from $376,000 to $23,000,000. BPA's *50th Anniversary History* later concluded that the revenues from industrial sales "saved the Bonneville system from being wrecked by the private utilities. It gave the preference customers time to win their lawsuits, or their condemnation suits, or their buyouts of private utility properties after WWII. Public power, protected by the aluminum markets, was able to come in and build on top of the Bonneville system."[7]

Over the years, BPA was directed to market virtually all power from Federal projects in the Pacific Northwest. In addition, BPA's rate directives were modified to expressly include the goal of cost recovery. BPA was directed to dispose of Federal power "to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," which rates were to "be drawn having regard to the recovery … of the costs of producing and transmitting such electric energy." 16 U.S.C. § 825s. But the basic marketing directives on which BPA operated were not changed until 1964 when Congress adopted regional preference.

The Regional Preference Act of 1964 established the Pacific Northwest as BPA's primary service territory and gave preference to sales "for consumption" in the Pacific Northwest over all other sales. 16 U.S.C. § 837. This Act was adopted in response to the large increase in the generating capability of the Federal hydro system made possible by four large upstream storage reservoirs constructed pursuant to the Columbia River

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[4] "Columbia River (Bonneville Dam) Oregon and Washington," Hearings before the House Committee on Rivers and Harbors, 75th Cong., 1st Sess. 66 (April 22, 1937) (Statement of Governor Martin).
[5] *Columbia River Power* at 132.
[6] A. Hart, "Night Letter to Dr. Paul J. Raver," May 24, 1940, *quoted in* G. Tollefson, *BPA & The Struggle For Power At Cost* 133 (BPA 1987).
[7] Id. at 259 (quoting BPA employee Sam Moment).

Treaty of 1961 with Canada.[8] Neither Canada nor the Pacific Northwest could initially utilize all of the additional power the Treaty projects made available, so actual development of the projects depended upon power sales to California across the proposed Pacific Northwest-Pacific Southwest Intertie.[9] However, the region was not willing to agree to inter-regional transmission facilities without legislation to protect Pacific Northwest consumers, including DSIs, from the potential consequences of diverting hydroelectric power to serve the needs of the Pacific Southwest. BPA Administrator Luce explained that:

> "For years industries in the Pacific Northwest have been important customers of the Federal system. Their purchases have varied from more than 60 percent of the energy sold by Bonneville Power Administration in 1945 to an average of approximately 36 percent during the past 4 years. Their original plant investment is more than $350 million. Their plant replacement cost would be double that figure. They employ 15,000 Pacific Northwest citizen directly and another 30,000 indirectly. *The utility of those plants and the thousands of jobs which they have made possible are directly dependent upon the maintenance of a low-cost power supply. If Pacific Northwest Federal power – and that area has no low-cost alternative – is diverted to other regions, many of these industries would have to stop production. The Nation would not gain by shutting down these plants in order to export the power from the Pacific Northwest, and the impact on that region would be catastrophic."*[10]

The Regional Preference Act protected BPA's ability to make power sales to the DSIs and other Pacific Northwest consumers, but otherwise left the directives for sales within the region unchanged.

## II. Development of an Integrated Power System

By the mid-1960s, the region had developed most of the politically acceptable hydro sites in the region. Regional planners, including BPA, developed the concept of a "Hydro-Thermal Power Program" (HTPP) to meet growing power needs. The HTPP was conceived to meet two key objectives. First, the HTPP would permit development of an adequate and reliable power supply for the entire Northwest at the lowest practical cost. Second, the plan was designed to achieve optimal combination of all of the region's transmission and generating resources, both hydro and thermal, whether Federal, IOU or consumer-owned. To meet these objectives, regional utilities and the Federal government would plan, build and operate the region's entire system as if it were under a

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[8] *Columbia River Power* at 227-236.
[9] *Id* at 233.
[10] Congressional Record – Senate, April 23, 1964, p. S 6787 (emphasis added). This same point is made in *Senate Report No. 88-122 "Defining the Primary Marketing Area of the Bonneville Power Administration"* 88th Congress, July 25, 1963, page 7, the report that accompanied Senate Bill S-1007 which became the Regional Preference Act.

single ownership – "the one-utility concept."[11] Under the HTPP, high voltage transmission, peaking capacity, forced outage reserves and reserves for unplanned load growth were to be Federal responsibilities. Non-Federal utilities would build thermal generation, sized and timed for regional needs (instead of the needs of single owners) and build the low voltage transmission and distribution systems.

The transmission element of the HTPP required new legislation. The Flood Control Act of 1944 had explicitly narrowed BPA's authority to construct and own transmission facilities granted under the Bonneville Project Act. Under 16 U.S.C. § 825s, BPA was limited to construct or acquire "only such transmission lines and related facilities as may be necessary" to interconnect with customers' facilities to deliver "wholesale quantities" of Federal hydropower. Therefore, in 1974 Congress adopted the Transmission System Act, 16, U.S.C. § 838, to give BPA a very expanded role in developing transmission within the Pacific Northwest "to integrate and transmit the electrical power from existing or additional Federal or non-Federal generating units." 16 U.S.C. § 838b. In furtherance of this expanded role, the Act made BPA self-financing (*i.e.* BPA was authorized to use directly the proceeds from the sale of power and transmission services instead of sending the money to the Treasury) and authorized BPA to borrow money directly from the Treasury to spend on transmission facilities. But BPA's basic power marketing directives were not changed (16 U.S.C. § 838b), and its rate directives were expanded only to assure BPA did not discriminate between the transmission of Federal and non-Federal power and to recover the cost of any amounts borrowed from the Treasury.

In partial implementation of the HTPP, BPA entered into a number of agreements to acquire the output of thermal generation owned by preference customers through "net billing." However, the high cost of the new thermal generation, and an Internal Revenue Service ruling in 1973 that prevented the issuance of additional tax exempt net-billed bonds exhausted this avenue before the region's perceived need for additional generation could be fully met.

After net billing became unfeasible, the Region launched Phase 2 of the HTPP. During the short-lived Phase 2, the preference utilities individually and jointly were to build some of the thermal generation needed to meet the region's local growth, and the power system reserves provided by BPA's contractual rights to interrupt service to its DSI customers were expanded significantly. Role EIS at p I-19. However, the skyrocketing costs of the Phase 2 thermal plants and two court decisions requiring BPA to develop environmental impact statements under the National Environmental Policy Act of its role under the HTPP brought all progress under the HTPP to an abrupt end and created great uncertainties for the Region's electric power planning process. *Id*.

[11] "*The Role of the Bonneville Power Administration in the Pacific Northwest Power Supply System, Including Its Participation In a Hydro-Thermal Power Program*" Final Environmental Impact Statement, December 1980 (Role EIS) at p I-16.

## III. Purposes of the Regional Act

The conditions that derailed the HTPP set the stage for the Regional Act. The Regional Act was drafted to address four principal problems that were summarized by Senator Hatfield on the floor of the Senate.[12] First, the region needed a viable mechanism to "pool" power from the various generating resources throughout the region to allow them to jointly operate to meet the region's total load under the "one-utility concept." S 14693. Second, Congress did not believe it was feasible for local utilities to take over serving DSI loads (both because of the size of the loads and the fact that these loads were providing reserves to the entire power system), and it was not deemed consistent with the national interest for the DSIs to cease operations for lack of a power supply. Yet, the preference clause in the Bonneville Project Act, load growth on preference utilities' systems and the creation of new preference utilities coupled with a static supply of Federal power would soon preclude BPA from serving these loads.[13] *Id*. S 14693. Third, BPA did not have adequate power to serve even the expected loads of existing preference customers or new ones that were forming, and Congress wished for BPA to avoid the need to allocate the resulting deficiency. *Id*. Finally, the high cost of the thermal plants developed by the region's IOUs under the HTPP had produced a huge retail rate disparity between the IOUs and publics and created political pressure for Oregon to become a public power state and aggravate the Federal power deficiency. *Id*. S 14694.

The central element of the solution to each of these problems was to be addressed by granting BPA the authority to acquire resources.

> "Reduced to one sentence, the heart of the regional power bill is the authority for BPA to acquire from non-Federal entities additional electric power resources, including conservation, *to meet the electric needs of Northwest customers*." (Senator Jackson at S 14690 (Green Book at 105) emphasis supplied).

Although BPA was authorized to acquire resources, it was not authorized to construct or own any generating facility; rather, BPA was authorized to purchase the output of facilities owned by other entities in the region.[14] Congress expected that by purchasing the output of customer-owned generating facilities, BPA could reduce the cost of financing such facilities by billions of dollars. (*See* p. 10, below.)

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[12] *See* Congressional Record, Senate, S 14692-5, Nov. 19, 1980 quoted in "*Legislative History of the Pacific Northwest Electric Power and Planning Act*" (BPA 1981) at pp 107-10 (the "Green Book").

[13] As the United States Supreme Court observed in upholding the initial DSI contracts under the Regional Act, "preference was the perceived problem, not the chosen solution" under the Act. *Aluminum Company of America v. Central Lincoln PUD*, 467 U.S. 380, 395 (1984).

[14] H. Rept. 96-276, Part II, 96th Congress, 2nd session 1980 at 278; (Green Book at 278).

## IV. The Regional Act as a Permanent Solution

The Regional Act was plainly intended to provide a long-term solution to the problems it addresses. The overarching purpose of the Act is "to assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply" — not just in the short run, but for the indefinite future. 16 U.S.C § 839(2). All Northwest utilities and existing DSIs were authorized to place specific loads on BPA — requirements net of resources in the case of utilities, and historic loads in the case of DSIs. 16 U.S.C. §§ 839c(b)(1) and 839c(a)(1)(A). BPA's obligation to honor requests for power from utilities was open-ended and perpetual. 16 U.S.C. § 839c(b)(1). BPA, through conservation and resource acquisition, was required to attain and maintain a sufficiency of resources to meet its contract obligation to supply power. 16 U.S.C. § 839d(a)(2).

The legislative history confirms that long-term power supply adequacy was a primary goal of Congress; the House Interior Committee report noted that the Act "expands the authority of BPA to permit it to acquire additional resources on a long-term basis to meet the needs of the region." H. Rep. No. 96-976, Pt. II, 96th Cong., 2d Sess. at 32 (1980)(Green Book at 274).[15] Indeed section 6 of the Regional Act made it mandatory for BPA to acquire sufficient power to serve its contractual obligations, declaring that the Administrator "shall acquire" such power. 16 U.S.C. § 839d(a)(2). There can be no doubt but that Congress expected that BPA would have "sufficient power to meet each … customer group's load requirements." H. Rep. No. 96-976, Pt. II, at 34. As BPA Administrator Munro stated in a letter to Representatives Ullman and Foley urging passage of the Act, "[p]urchase authority is the key. … If granted, it would instantly remove the theoretical and legal limit on the size of the federal power pool."[16]

### A. Sales to Publics

Section 5(b) of the Regional Act required BPA to contract to sell power to preference customers to meet their load requirements to the extent such requirements exceeded the resources they owned. 16 U.S.C. § 839c(b). The purchase authority conveyed (and obligations imposed) by section 6 of the Act assured BPA of having sufficient resources to meet these requirements without the need to allocate insufficient power among such customers as would have been required without the Act. 16 U.S.C. § 839d(a)(2). In addition, section 7(b) of the Act assured preference customers that their power costs would not exceed the costs of the resources of the Federal Base System plus the additional resources acquired to meet their load growth. 16 U.S.C. § 839e(b).

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[15] In effect, the Regional Act gave BPA specific statutory authority to carry out the "public utility responsibility" that BPA Administrator Paul Raver had always believed BPA had undertaken as a practical matter beginning in 1937. *Columbia River Power* at 185.

[16] Letter, S. Munro to Reps. Ullman & Foley, April 27, 1979, *reprinted in* Hearings on Northwest Power Legislation, H.R. 3508 and H.R. 4159 before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce, 96th Cong., 1st Sess. 81-82.

## B. Sales to IOUs

Section 5(b) of the Regional Act also authorizes BPA to sell power directly to IOUs. However, this provision was never intended to convey to the IOUs direct access to low-cost Federal power, or to reduce the access of public agencies and DSIs that were purchasing such power when the Act was adopted and whose rates were tied by the Act directly to the costs of the Federal Base System. As BPA stated in its section-by-section analysis of the Regional Act: "[I]t is important to note that under this Act, BPA would sell no power to the IOUs not first sold by them to BPA." (Green Book at 84) Such power includes the Residential Exchange power discussed below and power purchased by BPA from the IOUs under section 6(a)(2) for sale by BPA to IOUs under 5(b) to meet the IOUs' net requirements. As Senator Hatfield explained on the Senate floor:

> "The local utilities will build all future thermal generating plants, as they do now when and where they decide. Bonneville cannot purchase the output of a plant unless it can be matched against an existing contractual obligation to supply power. … Under 5(b), (c) and (e), if any utility fails to supply BPA with enough power, BPA can restrict its obligation to that utility to the amount of power so supplied."

(Congressional Record – Senate November 19, 1980, S 14964 reported in Green Book at 109)

Theoretically, if there were surplus firm Federal Base System power not needed to meet the loads of public agencies and DSIs, BPA could sell such surplus to the IOUs, but no such surplus exists. When no surplus is available, the only intended source of power for sale to IOUs is from resources acquired from IOUs. These section 5(b) sales to IOUs are to be made at rates established under section 7(f) to recover the cost of "additional resources which, in the determination of the Administrator, are applicable to such sales." 16 U.S.C. § 839e(f). In short, BPA was to resell power to the IOUs at the price BPA paid for such power. No benefit of low cost Federal hydropower was to be conveyed to the IOUs through their section 5(b) purchases. But, as noted below in section IV.D., the purchase and sale by BPA to IOUs was expected to provide substantial financing benefits.

## C. Sales to DSIs

In the case of the DSIs, the "initial long term" contract was explicitly made mandatory (16 U.S.C. § 839c(d)(1)(B)). All subsequent contracts were authorized, but not expressly required, by 16 U.S.C. § 839c(d)(1)(A). However, the use of the term "initial" (*i.e.* the "first") plainly implies that Congress expected BPA to offer subsequent contracts to the DSIs. This expectation is clearly reflected in the structure of the Regional Act, its legislative history and the contemporaneous actions of BPA as discussed below. The reason that the subsequent DSI contracts were authorized but not absolutely required is that, after the initial long-term contracts (for which BPA was

"deemed" to have sufficient resources), public preference would apply in the event of an insufficiency of resources. However, BPA was fully directed to and expected to achieve the overarching purpose of the Regional Act to acquire sufficient resources to meet all loads. The risk that BPA would fail to achieve sufficiency before expiration of the initial contracts was minimal. Thus, it was contemplated that, under the Regional Act, BPA service to DSIs would continue indefinitely and, as described in section IV.E., such continued service was a necessary condition for the Residential Exchange Program to work. Indeed, in 1981, when the BPA Administrator transmitted the contracts offered to DSIs, he explained in his cover letter that:

> "This contract is the initial contract that Bonneville is required to offer each Industrial Purchaser pursuant to sections 5(d)(1)(B) and 5(g) of the Regional Act. *As you know, the Act contemplates in section 5(d)(1)(B) additional, future contracts with each existing Industrial Purchaser,* but unlike this initial contract, such future contracts do not have the benefit of the statutorily deemed sufficiency of power available to the Administrator under section 5(g)(7). Bonneville's ability to offer any future contracts to its nonpreference customers, including the Industrial Purchasers, is therefore largely dependent upon Bonneville achieving load/resource balance while these initial contracts are in effect. *Bonneville is aware that most, if not all, of the Industrial Purchasers are necessarily considering substantial new capital investment at their existing facilities during the period of the initial contracts, and that as a result the useful life of these facilities may be extended well beyond the 20-year term of the initial contracts.*"[17]

In short, while BPA has the theoretical ability to decline to offer contracts to DSIs if inadequate resources are available to serve them, the overriding intent of the Regional Act and the planning and resource acquisition efforts it was designed to engender was to avoid such a situation ever arising.

## D. Financing Benefits

The Regional Act required BPA to offer power to preference customers, DSI customers and IOUs at a time that BPA believed it had insufficient power to go around. Therefore, Congress adopted a legal fiction and "deemed" BPA's resources to be sufficient to meet the contract obligations it was directed to incur. 16 U.S.C. § 839c(g)(7). Clearly, however, BPA would need real power to meet the growing real loads of its customers, and Congress anticipated that BPA would rely on customers themselves to provide BPA that power:

> "It is anticipated under this legislation that each BPA customer group will provide BPA, through the acquisition procedures of section 6, with sufficient power to meet each such customer group's load requirements. Section 5(e) of S. 885 will encourage these customer groups to actually provide BPA with such resources since it provides that customers will not

[17] Letter, P. Johnson to DSI Customers, Aug. 27, 1981, at 1-2 (emphasis added).

be restricted pursuant to section 5(b) below the amount of power that they have provided BPA pursuant to section 6."[18]

BPA's authority to purchase and resell power to its customers was intended to provide substantial benefits. As explained by Senator Hatfield, the purpose of these transactions was to facilitate the operation of the Pacific Northwest under a one-utility concept and to lower the cost of financing power projects:

> "I expect that the money market will regard with some favor a strongly integrated industry which this bill will allow to happen, but that is not the reason this bill was brought to Congress."[19]

Senator Jackson, a major sponsor of the bill put significant weight on the financing benefits of BPA purchase authority:

> "The advantage of the regional power bill for the Northwest will be enormous: … Second, Regional financing of resources through BPA will result in lower resource financing costs, primarily lower interest charges and reduced equity financing costs, which will save the region billions—not millions—of dollars."[20]

The Regional Act expressly provided that BPA could purchase the output from generating facilities owned by DSI customers (16 U.S.C. § 839c(e)(1)(C)) to resell to such customers and therefore, that the DSI customer could benefit from the financing benefit available by such BPA purchases.

## E. The Residential Exchange Program

Confirmation that long-term service to DSIs was an inextricable component of the Regional Act's structure is found in the Act's section 5(c) Residential Exchange provisions. 16 U.S.C. § 839c(c). The Act expressly ties power sales to the DSIs together with the Residential Exchange program such that BPA has no ability to provide Exchange benefits without making sales to the DSIs.

The sole lawful means for BPA to address the wholesale rate disparity between residential and small farm customers of IOUs and preference customers was the Residential Exchange program. Section 5(c) of the Act establishes an exchange of power between BPA (at a price based on the rates applicable to other BPA regional customers) and the IOUs (priced at their "average system cost"). As noted in BPA's section-by-section analysis of the Act: "This [Exchange Program] is intended to provide rate relief to residential and small farm customers of IOUs." (Green Book at 86) But, the Act places many constraints on the Residential Exchange Program.

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[18] H. Rept. 96-976, Part II at 34; (Green Book at 276).
[19] (S 14694; Green Book at 109).
[20] (S 14691; Green Book at 106).

The most relevant constraint is found in the mandatory rate directives contained in section 7 of the Act. 16 U.S.C. § 839e. As summarized in BPA's section-by-section analysis: 'Section 7(b)(2) establishes a rate ceiling for preference customers and Federal agencies which assures that their rate will not exceed what they would have been had BPA not engaged in power sales or purchase transactions with IOU. Costs that may not be recovered from preference customers [due to § 7(b)(2)] are to be covered from other customers from other rate schedules." (Green Book at 92)

Section 7(b)(2) is more complicated than is apparent from the brief summary in BPA's section-by-section analysis. As the Supreme Court has concluded, the key to supporting the Residential Exchange benefits was BPA's sale of power to the DSIs. "The Act expressly contemplates that much cost of this [residential exchange] program is to be covered by power sales to the DSIs. … [T]he DSI sales and power exchange program were integrally related." *Alcoa v. Central Lincoln PUD*, 467 U.S. 380, 399-400 (1984). During the period from the passage of the Act through June 30, 1985, § 7(c)(1)(A) of the Act's rate directives directly allocated the cost of the Exchange to the DSI rates, to the extent such costs were not recovered from other customers. 16 U.S.C. § 839e(c)(1)(A). After July 1, 1985, two new rate directives became effective under the Act and altered the financial support for the Exchange Program. First, section 7(c)(1)(B) tied the DSI rate directly to the rates charged by BPA to public agency customers, and second, the section 7(b)(2) rate ceiling that limits BPA's authority to recover Exchange costs became effective. 16 U.S.C. §§ 839e(c)(1)(B) and 839e(b)(2).

After July 1, 1985, the section 7(b)(2) rate ceiling forbids BPA to charge the public agencies rates higher than their power costs would be under a hypothetical world in which certain effects of the Regional Act are assumed not to exist. 16 U.S.C. § 839e(b)(2). Specifically, section 7(b)(2) capped the publics' rate at a level that expressly excludes the costs of the Residential Exchange and includes instead the additional cost the publics were assumed to bear if the publics served the DSIs located in public agency territory with fully firm resources and without the power system "reserves" available to BPA through BPA's contractual rights to interrupt service to the DSIs. Under this statutory assumption, the publics would have to install additional costly generating resources to serve the DSI loads and replace the contractual reserves. In addition, the potential for cost savings under the Act of having BPA's credit standing behind the borrowings the publics would incur to install resources was assumed to be unavailable in the section 7(b)(2) world.[21] In effect, the rates BPA charges publics was lawfully allowed to include Residential Exchange costs only to the extent that BPA's service to the DSIs provided costs savings or revenues to offset those Exchange costs.

If and to the extent the benefits of BPA's service to the DSIs did not offset the cost of the Residential Exchange, BPA was to surcharge all rates uniformly, other than rates for sales to the publics, sufficient to recover the costs. Such other rates include the rate for the Residential Exchange (in effect, reducing Exchange benefits), the DSI rate

[21] BPA does not currently believe there are any financing benefits for the publics because, unlike the DSIs and IOUs, the publics are authorized by law to issue tax-fee bonds, generally at rates lower than BPA's own borrowing rate.

and rates for direct sales to the IOUs. If no direct sales were made to IOUs, then the cost would be shared between higher DSI rates and lower Exchange benefits with most of the cost absorbed by reducing Exchange benefits.[22] Thus, it is clear that there can be no Exchange benefit under the Regional Act unless BPA offers to serve the DSI loads.

The language and legislative history of the Regional Act, contemporaneous construction of that Act by BPA and others, and the fundamental purposes of the Act all compel the conclusion that Congress intended BPA to provide continuing service to the DSIs as part of its overarching mission to provide an adequate power supply for the Region. Indeed, under the Act's design, the important statutory purpose of reducing disparities between the residential and small farm rates of publics and IOUs can only be achieved through such continued service to DSIs. BPA has no authority to simply transfer money to IOUs or to sell them power earmarked for residential consumers except through the statutory Residential Exchange program.

## V. Clarifying BPA's Load Obligations for the Future

While the Regional Act expressly obligated BPA to offer contracts to regional utilities and plainly contemplates that BPA would offer contracts to DSIs indefinitely as well, the precise terms of such contracts were left largely to negotiations between BPA and customers and to the discretion of BPA. In 2001, BPA chose to allow customers to wait to decide whether to put loads on BPA until after BPA had established rates, and only shortly before deliveries under the contracts were to begin. As a result, BPA substantially underestimated its load obligations, set rates that were inadequate, and was caught short of resources in what turned out to be an extraordinarily high-priced market. BPA and all of its customers were seriously harmed by these events.

BPA needs to insist that it have adequate notice of the loads its customers will place on it to allow it to arrange for resources or other power supplies in a considered and business-like fashion. On the other hand, BPA cannot expect essentially firm commitments from customers to purchase power unless it provides customers reasonably firm prices. This essentially requires that BPA solicit notice of intent to purchase and proposals to sell well in advance (preferably 3-5 years) of the commencement of deliveries, and negotiate the purchase and sales agreements simultaneously to arrive at load/resource balance at known rates. These known rates should be available only for load identified by customers during the notice period.

This is not to suggest that BPA should refuse to serve customers' loads if the customer fails to provide timely notice of its intent to place loads on BPA. There is no need for BPA to do so. BPA has broad authority on how to design its rates within the cost recovery directives. 16 U.S.C. § 839e(e). Moreover, all of BPA's customer specific rate directives authorize BPA to establish "rate or rates" for each customer class. In the case of section 5(b) sales to the IOUs, BPA has the flexibility to set a separate rate for each and every sale to an IOU under 16 U.S.C. § 839e(f). For publics, section 7(b)

[22] Residential loads will substantially exceed DSI loads on BPA, so any surcharge would serve to reduce Exchange benefits substantially.

applies only to rates of "general application" (16 U.S.C. § 839e(b)(1)) and need not be read to preclude BPA from setting special rates for power requests made after a notice period. Similarly, for any DSI that fails to provide the requested notice, the section 7(c)(2) "applicable wholesale rate" would be the same as for a public agency customer that failed to provide notice, presumably the cost of the specific resources acquired to meet the load.

Thus BPA can allocate its base costs to loads from each customer class for which it has timely notice. It can create a second tier rate for each customer class to cover the incremental costs of incremental loads in excess of the amount for which BPA receives timely notice. In short, BPA can solve the entire issue of defining its post-2006 service obligation by requiring from each customer advance notice of intent to purchase coupled with a second tier rate applicable to customer's loads that exceed the noticed amount.

## Conclusion

Under the Regional Act, BPA should be prepared to serve the full net requirements of all regional utilities and of the DSIs at statutory rates when provided reasonable notice. In order to balance power supply and demand, BPA should require from each customer multi-year notice of the intent to purchase and then negotiate simultaneously power sales and resource acquisition contracts. Loads for which timely notice is not provided should be subject to special rates designed to recover the full cost of meeting those incremental loads with incremental resources. In addition, BPA should stand ready to purchase the output of an appropriate customer-owned resource to provide the financing benefits contemplated under the Regional Act, and sell power to such customer as intended under the Regional Act.