

W. Bill Booth
Chair
Idaho

James A. Yost
Idaho

Tom Karier
Washington

Dick Wallace
Washington



Bruce A. Measure
Vice-Chair
Montana

Rhonda Whiting
Montana

Melinda S. Eden
Oregon

Joan M. Dukes
Oregon

November 6, 2008

MEMORANDUM

TO: Council Members

FROM: Terry Morlan
Director, Power Planning

SUBJECT: Presentation by Alcoa on Proposed Principles for Electricity Service from Bonneville.

Alcoa Aluminum will make a presentation to the Council on principles for a proposed power sale from Bonneville to Alcoa starting in October 2011. If Bonneville decides to go ahead with this sale, it would need to augment the federal power system to provide the additional capability. Council members have been provided information on this from Bill Hannaford during the past few weeks.

The proposed amount of the sale would be 240 megawatts. If this power is acquired for more than five years, it would require that Bonneville initiate a section 6(c) process under the Act to determine consistency of its proposed acquisition with the Council's Fifth Power Plan. Following the Bonneville Administrator's determination under a 6(c) process, the Council would have a choice of whether or not to make its own 6(c) consistency determination.

If Bonneville decides to make the power sale to Alcoa, the extra cost of the capability would be assigned to Bonneville's other tier one rates. This will likely prove unpopular among Bonneville's utility customers as they decide about signing Regional Dialogue contracts.

We have invited the Public Power Council to offer its views on the proposal following the Alcoa presentation. The Power Committee packet contains more information.

You should also be aware that Bonneville would make the same offer to Columbian Falls Aluminum Company. However, it is less likely that Columbia Falls would want actual power and would instead prefer a financial agreement similar to the current agreements with Bonneville. The financial agreements would not require augmentation of Bonneville's system and would not, therefore, trigger a 6(c) process.

BPA/Alcoa Memorandum of Understanding

To Provide a Limited Amount of BPA Power for the Operation of Alcoa Intalco Works after 2011

1

Overview of Presentation

- Alcoa Intalco Works.
- The MOU and contract framework.
- Legal Issues are in dispute.
- Equity supports BPA service to Intalco.
- The importance of timing.
- BPA market purchases under the MOU.
- Alcoa request of the Council.

2

Alcoa Intalco Works

- Intalco is an aluminum reduction plant in Ferndale, WA owned and operated by Alcoa.
- Richard Conway Study updated with 2007 data in 2008.
 - Intalco directly employed 640 workers.
 - Intalco responsible for 2,170 jobs in WA.
 - Intalco responsible for \$189 million in WA gross domestic product.

3

The MOU and Contract Framework

- Following an appropriate public process, BPA may offer a contract to Alcoa with the same duration as other BPA contracts offered to preference customers and to IOU customers under its Regional Dialogue process (2011-2028).
 - Up to 240 MW to Alcoa.
 - BPA may offer a contract to Columbia Falls Aluminum Company with commensurate costs and benefits for up to 105 MW, but that is not part of this MOU.
- BPA will purchase needed power from market parties if it can acquire power at specific prices designed to limit impacts on other BPA customers.
- BPA will sell the power to Alcoa at the Industrial Power (IP) rate determined in each rate case.

4

Legal Issues are in Dispute

- Alcoa believes the NW Preference Act of 1964 and the NW Power Act of 1980 were intended to provide full power service from BPA to Intalco, and other BPA Direct Service Industrial (DSI) plants.
- Others assert it would be illegal for BPA to continue to serve aluminum plants.
- BPA believes it has discretion to serve DSI loads.
- Legal issues will eventually be decided in court
 - If Alcoa prevails, a different contract may be required.
 - If others prevail, the Alcoa contract may end.
 - If BPA prevails, the proposed MOU and contract should endure because the MOU is based on equity.

5

Equity Supports the MOU

- Alcoa has been a BPA customer for almost 70 years.
- Alcoa helped lower rates to all BPA customers and build the federal hydroelectric power system.
- At some point in time BPA power served 6 different Alcoa plants in the Northwest totaling more than 1800 MW.
 - All of that is now concentrated in Intalco in an effort to allow that plant to survive.
 - The MOU would reduce Alcoa loads on BPA to 240 MW.
- Intalco has been a part of the Ferndale social structure for over 40 years.
 - It would cause economic hardship to the local community if BPA were to cut off power and force the plant to close just so other customers could have slightly lower power rates.
- Other industries in public power communities will continue to have all of their power requirements met by BPA power through local utilities.
- It would not be equitable to meet regional load growth through discontinuing all service to the DSIs.

6

Equity Continued

- This is not a subsidy from other BPA customers.
 - This MOU would provide power for about half of the Intalco plant at rates that are currently about 38% higher than rates to consumer-owned-utilities.
- If BPA is able to purchase 240 MW of power at target prices for 10 years, Alcoa will commit to an annual payroll of \$48 million and can justify investing \$160 million in capital to keep the plant efficient and improve environmental performance (including greenhouse gas reductions).

7

The Importance of Timing

- Alcoa and BPA have worked to reach agreement on the framework for a post-2011 contract for many months.
 - BPA insisted on capped exposure.
 - Alcoa insisted on workable economics.
 - Until recently, markets prices did not allow the two to intersect.
- However, recent market trends indicate that it may be possible in the near future to allow Intalco operations and limit exposure to other BPA customer rates at the same time.
 - Markets are unpredictable and can change quickly.
 - Regional parties must be prepared to act quickly to take advantage of potential market conditions.

8

Timing Continued

- BPA power acquisitions under the MOU could occur quickly or slowly depending on how they occur.
 - They could be very rapid as they are for non-major market purchases.
 - They could take over a year to complete if all of the potential time allowed for a Major Resource acquisition in Section 6(c) of the Northwest Power Act is used.
- The length of time required to complete a purchase may make a difference on whether or not BPA is able to make economical purchases under the MOU.
- Failure to make a timely purchase could:
 - Result in higher BPA purchase costs.
 - Result in Intalco closure.

9

BPA Market Purchases under this MOU

- Market purchases under this MOU are considerably different than the “Major Resource” acquisitions contemplated in Section 6 of the NW Power Act.
 - Market purchase rather than a generation resource.
 - Purchases under this MOU have a different risk profile.
 - Alcoa assumes the risk of non-performance.
 - Alcoa assumes the risk of stranded costs.

10

Alcoa Request of the Council

- Please work with BPA to minimize the process time necessary for BPA to acquire power under the MOU.
- Please eliminate any duplication of processes involving BPA and the Council.
 - BPA will go through a public process concerning the proposed MOU, framework and contract with Alcoa.
 - Any Council process should concentrate on BPA purchases and not duplicate BPA processes on the BPA/Alcoa contract.