



The Aluminum Industry

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The Aluminum Lobby:

Impact of the Direct Service Industries on Electric Consumers of the Northwest

S b t e y

The history of the Direct Service Industries (DSIs) is a very checkered one. This group of high-electricity-use manufacturers includes 10 aluminum plants, a chlorine manufacturer, and a couple of smaller metal producers. The DSIs purchase their power directly from the Bonneville Power Administration (BPA) instead of through utilities, most recently under a 20-year contract made in 1980. While these manufacturers don't have any legal entitlement to obtain power directly from BPA, since last October, BPA has the right to continue to sell power to them if it chooses. This relationship between Bonneville and the DSIs has tied the Northwest in knots

and cost ratepayers billions of dollars. The story contains a lesson learned the hard way by many business people: it is dangerous to depend too much on one customer. As the BPA has learned, doing so gives that customer huge leverage and can lead to incestuous excess.

Together, the DSIs historically have used over 3100 average megawatts (aMW) of power—enough to power three cities the size of Seattle. Over the last few decades, they've consumed anywhere from 30 to 40 percent of all the power produced by one nuclear plant and the many federal dams along the Columbia and Snake Rivers. The buying power of the DSIs combined with their

formidable lobbying influence in Washington, D.C. has led, and continues to lead, to significant leverage at Bonneville. A revolving door of key BPA executives who end up working for the DSIs (including Randy Hardy, a recent BPA Administrator, and Ray Bliven, a senior rates modeler), a host of sweetheart deals, and special treatment at the expense of other BPA customers and the environment continue to compromise the interests of residents of the Northwest.

A thorough history of this remarkable relationship would require too much space. Instead, after providing some background, I will illustrate the leverage wielded by the DSIs and the damage this leverage has caused.

History

FDR's populist vision to electrify and irrigate the Northwest was primarily aimed at residents and small farmers—the voters. When the federal government built the dams on the Columbia, its purpose was twofold: to promote economic development and to provide service to rural areas that had failed to be served by the region's Investor Owned Utilities (IOUs). The dams were so huge, and their power production so large, that in 1941 people believed demand would never exceed supply, and there was no reason to authorize the BPA to develop additional generation.

During WWII, the Defense Materials Administration entreated aluminum companies to locate in the Northwest to produce aluminum for planes and ships. However, the laws authorizing construction of the dams were crystal clear in designating priority use of the power for "preference" customers, which did not

include the aluminum industry. Preference customers were defined as municipal and rural consumer-owned populist utilities rather than for-profit IOUs serving most urban areas. While this preference was clear in law, it had no practical consequence for many years. Even into the 1960s, the BPA had enough hydropower to sell to everyone.

Electricity was so cheap that Northwesterners built "All-Electric Homes" by the thousands, installed millions of acres of irrigation pumping systems, and attracted scores of energy-intensive industries. Per-capita electricity use in the Northwest was over double that of other regions of the country. The catch was that booming energy use meant cheap power couldn't last forever. By the early 1970s, the DSIs could see the handwriting on the wall.

BPA didn't have a true power shortage; its dams could easily provide enough power for its preference customers for many years to come. However, without the legal authority to build new power plants, BPA would have no other choice but to let the DSIs' contracts lapse.

For the DSIs, this meant that either expensive power lines would have to be built to bring Wyoming coal-fired power to the Northwest, or nuclear plants would have to be built. (Efficient natural gas turbines hadn't been invented yet, and there was a congressional prohibition on using natural gas for other than home use because of the OPEC oil embargo.) The DSIs simply couldn't afford to build their own power plants (and still can't), and neither could local utilities, without raising rates enormously, if the DSIs attempted to get service from them. To survive, the DSIs

had to somehow hold onto cheap BPA power.

In 1974, the DSIs successfully lobbied BPA Administrator Don Hodel (Ronald Reagan's future Secretary of Energy, who once proposed that the Northwest build over 20 nuclear plants) to renew the DSI contracts until 1985. The extension forced BPA to issue a "Notice of Insufficiency" in 1997 to its preference customers—consumer-owned utilities—informing them that in seven years there wouldn't be enough power from BPA to serve all their needs.

BPA's forecasts of load growth had caused the agency to, through a complex end run around its mandate, guarantee debt for building of three nuclear power plants. Nevertheless, the notice of insufficiency shocked the utilities into further action. Because of the overoptimistic forecasts, they signed up with the consortium known as the Washington Public Power Supply System (WPPSS) to start construction of Washington Nuclear Projects (WNP) 4 and 5. The rest is history: BPA assumed billions of dollars in debt for WNP 1, 2 and 3, finished only one, and quadrupled its rates. The fallout from this debacle and the impending default of WNP 4 and 5 spurred Congress to pass the 1980 NW Power Act.

This law has many benefits: requiring mitigation of the damage the dams have done to salmon, creating the residential exchange, which shares low-cost BPA power with residential customers of the IOUs, and making conservation and renewables a priority. The DSIs got their piece: BPA was given the authority to acquire power from new power plants, and the DSIs were given another contract extension for the

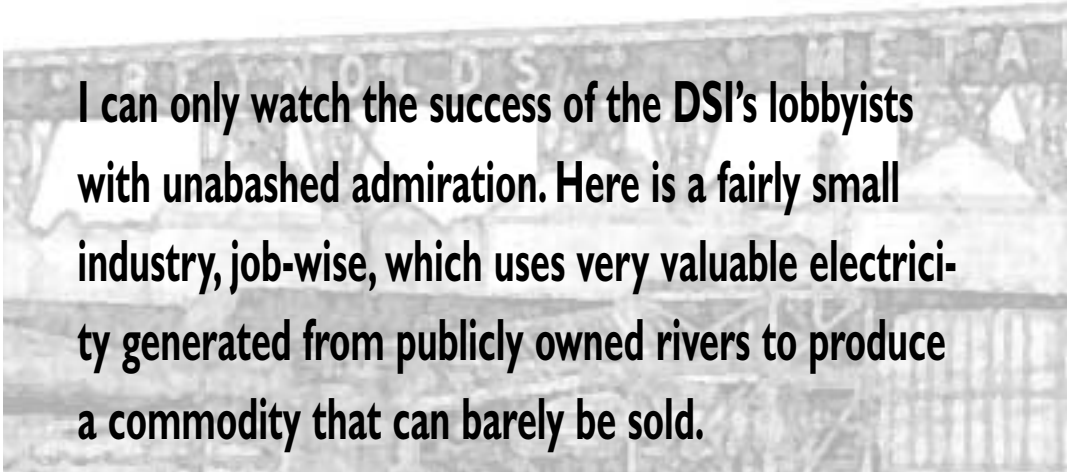
period 1981-2001 at rates roughly comparable to those of other manufacturers serviced by public preference utilities. The DSIs did not want to build new plants themselves but did not want to pay the cost of BPA's acquiring new power. They wanted to be treated like preference customers.

Years of special deals followed. In a deal using "variable rates," BPA shared the commodity price risk inherent in aluminum markets by tying the cost of electricity to the price of aluminum. Essentially, BPA was in the aluminum business. Another such arrangement was huge discounts to the DSIs for the ability to interrupt service in case of a short-term emergency, such as a transmission line outage or an

looked like they might fall below BPA's rate. The DSIs, who in the sixties and seventies had pushed the region into acquiring expensive nuclear power, now wanted to be released from their 20-year contracts so they could buy power from the wholesale market. Of course, doing this would be a risky proposition because market prices could go back up, but it was a good threat to use against Bonneville. (In fact, the few DSIs who believed their own propaganda and left BPA got severely burned. Vinalco actually went bankrupt from this decision.) BPA, however, bought into the threat and was nervous that if the DSIs left to pursue low market prices, the agency would have to dump the power the DSIs left

made on behalf of fleeing customers), BPA reacted by offering a sweetheart deal to the DSIs to get them to stay—essentially offering them below-cost power

To pay for the deal, Bonneville would later slash its conservation budget from \$200 million per year to about \$20 million, a 90 percent cut. BPA also offered the DSIs a perpetual stranded-cost "shield" and direct access to the transmission system if the DSIs would stay on BPA service until the end of their original contracts on Sept. 30, 2001. The transmission access was a huge gift, as it allowed the DSIs to always be able to threaten to leave BPA without paying stranded costs—something no other customer could do.



I can only watch the success of the DSI's lobbyists with unabashed admiration. Here is a fairly small industry, job-wise, which uses very valuable electricity generated from publicly owned rivers to produce a commodity that can barely be sold.

"arctic express" (extremely cold, plant-damaging weather). Utilities usually have this arrangement with their large customers for free because tripping of a large user actually shortens outages and the whole system does not have to shut down.

One of the most profitable deals occurred in 1995. At that time, due to an energy glut, wholesale market prices for power

behind into that same low-price market and face what are called "stranded," or unrecoverable, costs.

However, in 1995, instead of insisting that the DSIs be held to their contracts or that they be made to pay any stranded costs (a right which the Federal Energy Regulatory Commission had just given for-profit utilities to cover long-run investments they had

This astounding offer met with such criticism that the U.S. Department of Energy (USDOE, Bonneville's boss) prohibited BPA from going forward. But the very day USDOE announced its intentions, it was also forced to issue a press release reversing the announcement. The DSIs had enlisted Sens. Mark Hatfield, Slade Gorton and Patty Murray to go into Energy Secretary Hazel

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O'Leary's office to pressure her to change her mind. Faced with the powerful senators literally sitting on her desk, the Secretary capitulated. The DSI's had won, this time at the expense of millions of dollars of energy efficiency improvements.

That brings this story up to present developments. BPA once again had the opportunity to redefine its relationship to the DSI's as their contracts expired this October. The battle started a few years ago as Bonneville went through its "subscription" process to define who got its limited supply of power. Two years ago, with power prices still almost as low as BPA's rates, BPA officials feared that the system's power would not be fully subscribed. BPA even started to sell some of its supply to California. BPA Administrator Judi Johansen then announced her solution: first, preference utilities could get all the power they wanted. Then residential and small-farm customers of private Northwest utilities could get as much power as they wanted. Finally, the DSI's would get up to their average usage (3000 aMW). Any leftover power would be sold to out-of-state buyers. Everyone seemed happy, because with market prices so low, no group thought

BPA power would be over-subscribed.

But soon market prices skyrocketed, and demand for BPA's cheap power became overwhelming. The first two categories of customers claimed over 100 percent of BPA's power. BPA limited the IOU's allowance to half their residential customers' needs, but it still looked like the DSI's would get nothing

because they had no legal right to the power. Many believed the DSI's' willingness to leave BPA in the lurch back in 1995 revealed their true colors to the region and that this time they would finally lose the political fight. But they underestimated the DSI's. The DSI's played their D.C. trump card. Bill Richardson was now the Energy Secretary, and he was out to elect Al Gore. The DSI's had no clout with this pro-worker cabinet member, but their steel-worker unions sure did. A mass of union members poured into D.C. and into Richardson's office. With no review of the situation, the Secretary ordered Bonneville to give the DSI's power—at least 1,500 MW.

So BPA, faced with contracts to sell about 11,000 aMW and a firm supply of only 8,000, was forced to buy the extra needed from the market and meld the purchase with its other costs. Because the price of the market power was so high, BPA faced doubling its rates and responded with damage control: paying the DSI's to not use the power! This strategy is cheaper than serving them, but it's a remarkable development. The DSI's—who have never had any legal claim to Bonneville electricity, but very smart lobbying—were

promised millions for not operating for the next couple of years!

The exact cost of this scam is unknown, but hints from BPA set the price at around 2¢ for each KWh not used, to be paid for with other customers' money. Together with some heavy arm-twisting by BPA to convince utilities to purchase 10 percent less than they wanted, Bonneville was able to reduce its wholesale rate increase from over 200 percent to "only" 46 percent.

As an advocate myself—for the environment and low-income consumers—I can only watch the success of the DSI's' lobbyists with unabashed admiration. Here is a fairly small industry, job-wise, which uses very valuable electricity generated from publicly owned rivers to produce a commodity that can barely be sold; the world is awash in aluminum, with prices at record lows. Meanwhile, electricity is priced at record highs, industries have had to cut back or close, and BPA this summer stopped spilling water for endangered migrating salmon, claiming financial hardship (*See Corwin, Bloch or Sampson in this issue -ed*). Meanwhile the public is paying to keep these guys alive and shield them from business reality.

Why should aluminum companies in other parts of the country be made to compete with Northwest companies getting federal power? Closer to home we should ask, Why should a steel mill or coffee roaster served by a private utility such as PGE have no access to BPA's electricity when its competitor in Eugene—which has a city-owned utility—is considered a "preference" customer?

In the commercial world, electricity should be sold to the highest bidder; then aluminum

companies would have to compete with other users on a level playing field. This is only fair public policy. If air-conditioning is valued more than beer cans, those using air conditioners will be willing to bid more for the power needed, because they want cold air more than canned beer. (Maybe they'll purchase beer in bottles instead.)

The ultimate solution is to have all businesses, including the aluminum companies, compete in a fair market. We should go back to the fundamental goals that guided BPA's decisions years ago: (1) to benefit residential customers, with an emphasis on rural communities, and (2) to provide assistance to public institutions and cooperatives.

The value of publicly owned rivers should be kept for the public: BPA's cheap electricity should go primarily to residential customers and public institutions such as schools, fire departments, city halls, water and sewage facilities, and hospitals. To affect such a broad change would require amending the NW Power Act. However, in the meantime, BPA can stop throwing money at the non-preference aluminum industry. For the health of the region's economy and environment, BPA needs to get out of the aluminum business.

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