BPA'S FAILURES AND THE DE-INDUSTRIALIZATION OF THE PACIFIC NORTHWEST

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As the lights go out in California, and the lights threaten to go out here, it seems appropriate to look back and review the history of the Bonneville Power Administration, and try and figure out how we got where we are. Where we are for an aluminum company is not a happy place, because the BPA wants us to shut down for two or more years so it can take the power it promised to sell us—that's promised as in "signed a contract"—and use it to lower average rates for the rest of BPA's customers. Beyond that, BPA is pursuing a strategy that is destroying productive enterprises all over the Pacific Northwest, in order to subsidize consumption by residential ratepayers.

I want to review in detail the energy history of the Pacific Northwest, because once upon a time, BPA made us all richer. Once upon a time, BPA acted as an enlightened public servant fostering a growing Northwest economy. The first BPA Administrator, J.D. Ross, was an engineer who embodied the ideal of a neutral expert who could fairly implement general policies of Congress.

But decision by decision, BPA has devolved into a gaggle of politically-correct regulators and rationers, less concerned with enriching the Pacific Northwest than controlling it. And with this crowd has come a series of misrepresentations about the aluminum industry, starting with the idea that the industry came to the Pacific Northwest in search of "subsidized power".

How Energy-Dependent Industry Came to the Pacific Northwest

The dams that comprise the Federal Columbia River hydropower system started as emergency public works projects during the Great Depression.[1] Opponents of the dams warned that they would become useless monuments to government folly, with their electricity going to waste. The Bonneville Project Act, which formed BPA, did not create subsidized power; rather, BPA was directed to set rates at the lowest possible levels "having regard to the recovery . . . of the cost of producing and transmitting such electric energy, including the amortization of the capital investment over a reasonable period of years".[2]

The 1930s began the fight to authorize public utility districts, but despite widespread rural electrification efforts, residences and small farms could not begin to consume the amount of power generated by the Federal dams. By 1939, BPA was under intense public pressure to get its power sold, and BPA actively sought industrial load. The contract for power to the first aluminum plant was signed in December 1939, and by the end of 1941, three more aluminum plants had been announced. After Pearl Harbor, Congress quickly realized the importance of the aluminum industry, and began pushing BPA to construct more transmission lines to deliver power to more plants. Aluminum plants, Kaiser's shipyards and Boeing's aircraft factories produced the ships and planes

without which the United States could not have won World War II. Indeed, one-third of the light metals consumed by the World War II defense effort came from BPA power.[3] And a mystery load in Hanford, Washington, which consumed more power than all of the PUDs, cooperatives and municipal customers of the Region combined, helped produce the atomic weapons that defeated Japan.

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. Aluminum plants constituted BPA's largest load. As BPA's largest customers, the aluminum plants paid the largest portion of the costs of generating the electricity, and the largest share of dam construction costs, as they did for many, many years thereafter.

Hydropower facilities have high capital costs, but no fuel costs, because the water "fuel" is free. When first constructed, hydroprojects generate electricity at costs that may exceed alternative sources of power. But over time, inflation tends to make hydropower look less and less expensive, because the capital costs are assessed to the customers based on fixed repayment terms—akin to level home mortgages. The aluminum companies covered the fixed costs in the early years, when hydropower was relatively expensive. Much of the public agency load now favored by BPA arrived later, after decades of inflation had made hydropower costs much more attractive.

The payments from aluminum companies also provided political protection for BPA, by ensuring that BPA did not lose money. BPA's 50th Anniversary History reports that the continued industrial sales revenue "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."[4] Without aluminum power purchases to keep BPA financially solvent, the enemies of public power might have succeeded in dismantling BPA entirely.

The federal government continued to build additional dams for power production, with the 1948 Vanport flood providing strong political push for many dams to control the River. Upon his return from viewing the flood damage, President Truman ordered that the plans of all federal agencies for Columbia River development be consolidated and expedited.[5] By 1951, more than 90% of Northwest farms were electrified, and roughly half the people were served by IOUs and half by public power.[6]

Politicians outside the Pacific Northwest lament "subsidized power" for Northwesterners, but most of BPA's customers have paid the full cost of power production ever since the dams were built. BPA's prices have generally been less than market rates in recent years, but it is misleading to call this a "subsidy". Rather, BPA's customers in the Pacific Northwest are getting the benefits of prudent, long-term investments in electric power supplies, just as ratepayers across the nation have gotten get the benefits of their utilities' embedded-cost resources.

The Birth of Regional Preference

By 1964, BPA had entered into the Canadian Treaty, which added 20 million acre-feet of storage.[7] With this storage, and other storage reservoirs, BPA could engage in multi-year planning, saving water to cover temporary deficits, and thereby converting unreliable, "nonfirm" power to "firm power". Indeed, BPA developed a large surplus of firm power. To sell this power, BPA brought more aluminum plants into the Region.

BPA also sought and obtained approval from Congress to build large transmission lines to California, called the "Intertie". Through the Intertie, BPA hoped to be able to import power from California during the winter, when Northwest heating loads were large, and export power in the summer, when California air conditioning loads were high, thereby making both regions better off. But Northwest politicians zealously guarded the system their ratepayers had funded, and passed the Regional Preference Act to assure that the Pacific Northwest would get first crack at the available, low-cost power.[8] Under the Act, Congress forbade BPA from exporting any power unless there was no market for the power in the Pacific Northwest—unless it would otherwise go to waste.

The Shift to Thermal Power

By the middle 1960s, it was clear that the dam-building days were over—no new federal projects were likely to be authorized. Construction on previously authorized projects continued, including the Lower Snake River Dams, but other dams planned along the Middle Snake were stopped by conservationists. In those days, conservation meant the wise use of natural resources. The conservationists urged the Region to build other power plants instead, in areas of less natural beauty. Thus hydropower development stopped with roughly half of the power potential of the Columbia River left unharnessed.[9]

In addition to environmental objections, many forecasts suggested that large thermal power plants could be less costly; even nuclear power was projected to cost 3.5 mills per kwh, less than the cost of new hydro projects.[10] Engineers had also long-recognized that thermal power plants in the Northwest could complement hydropower. Thermal plants tended to be least costly when run at full capacity, while hydropower could be turned on and off to cover thermal outages and daily and seasonal changes in load. Together, both sets of plants could produce great efficiencies and economies if all plants were run in a "one utility" concept.

Throughout the 1960s and 1970s, BPA exercised leadership in the Pacific Northwest utility community, and acted as if it were a super-utility with a service territory extending throughout the Northwest. While BPA's governing statutes did not offer BPA this role by law, BPA took it in fact, and lead the Northwest toward long-term planning for the Region's load growth. In 1966, BPA called together public and private utility officials from throughout the Northwest, and announced the formation of a thermal planning task force, and by 1968, the Joint Power Planning Council had announced a plan

for $15 billion in new coal and nuclear plants. BPA had no authority to build thermal plants, but promised to finance Washington Public Power Supply System (WPPSS) projects through "net billing" arrangements with the Region's public utilities.

Over time, conservationists were replaced with environmentalists, who tended to oppose the construction of any power plants anywhere. Environmentalists began to oppose nuclear plants that had been urged as replacements for more hydro development.[11] Nonetheless, the Region headed into Phase I of the hydrothermal program, including the first three WPPSS plants.

In 1973, the Arab oil embargo hit, energy costs rose rapidly, and the twenty-year contracts BPA had signed with the Region's investor-owned utilities expired. BPA had warned the IOUs that it would not be able to renew these contracts, stimulating even greater interest in long-term planning and the construction of additional thermal plants.

In 1974, Congress passed the Federal Columbia River Transmission System Act, which gave BPA bonding authority to construct additional transmission lines.[12] Congress envisioned that private utilities would have principal responsibility for constructing new thermal power plants, and BPA would build the lines needed to integrate those plants into a single, highly efficient utility grid that used an optimal mix of hydropower and thermal power to serve the Region's loads.

The Rise of Environmentalism

Environmentalism grew stronger and stronger, and vague environmental laws began to hamstring development everywhere. In 1975, environmentalists launched a successful challenge to BPA's decision to amend an aluminum company's power sales contract, forcing BPA to spend five years on an Environmental Impact Statement entitled "The Role of BPA in the Pacific Northwest Power Supply System." The Administrator Hodel was moved to declare that the environmental movement

> "has fallen into the hands of a small, arrogant faction which has dedicated itself to bringing our society to a halt. They are the anti-producers and the anti-achievers. The doctrine they preach is that of scarcity and self-denial. I call this faction the Prophets of Shortage."[13]

That was the high-water mark of BPA's resistance to the enviros. Today what Administrator Hodel called a "small, arrogant faction" has for all practical purposes taken over BPA and many of the Regions' other government agencies.

Indeed, the problem of unreasonable environmentalism now threatens the Nation as a whole. Since 1980, we have closed half our oil refineries. Hundreds of coal companies have closed. More and more land is off limits to mining and energy extraction, even though this country has more forests than it did fifty years ago, when the population was much lower. We are in the hands of extremists who are managing us into

decline through an explicit policy of de-industrialization. The fate of the aluminum companies is but one facet of a much, much larger problem.

Scarcity Causes Conflict

By 1976, BPA had sent out notices of insufficiency to all of its preference customers, and advised the DSIs that there new contracts would not be renewed, the notices to be effective July 1, 1983. This ignited what Washington Governor Dixy Lee Ray called a "regional civil war" over electric power, with the three main customer groups of BPA—the preference customers, investor-owned utilities, and DSIs—all fighting for a share of the BPA pie. Federal legislation crafted by the Pacific Northwest Utility Conference Committee was introduced in 1977, but opposed by public power interests who said that enabling BPA to purchase additional resources would triple their bills to avoid a ten-fold increase in rates to aluminum plants[14]—the very same claims the public agencies are making today. At the same time, the State of Oregon threatened to turn the entire state into a public power district in order to get lower rates for its customers, served by investor-owned utilities.

By 1978, compromises were afloat under which the DSIs would pay higher rates, with the profits, so to speak, used to subsidize the Region's ratepayers who had voted against public power but still wanted the benefits, but the bills continued to fail in Congress. By 1979, Senator Hatfield had come up with the idea of making the bill more saleable by giving top priority in new resources to cost-effective conservation, and the concept of a Northwest Power Council emerged.[15] And, armed with the first in a long series of junk science reports on dams and salmon, Congressman Dingell declared that greater fish protections must be included in any law "because I like fish and furry little things".[16] Ultimately, fish and power interests forged a compromise bill.

The Northwest Power Act and Resource Acquisition

A central purpose of the Act was "to assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply".[17] Congress imposed broader statutory responsibilities upon BPA that essentially ratified the leadership role that BPA had exercised, though it established a new Northwest Power Planning Council that was to provide guidance from the Region’s Governors to BPA. Specifically, the Council was to prepare two plans to guide the federal agencies: "a regional conservation and electric power plan" and a "program to protect, mitigate and enhance fish and wildlife".[18] The power plan was set to "set forth a general scheme for implementing conservation measures and developing resources".[19]

Under the Act, BPA was given, for the first time, the authority to acquire additional power resources. This was the most important parts of the Act, for BPA now bore the ultimate responsibility in the area it had offered leadership for so many years: assuring an adequate power supply for the entire Region, regardless of the identity of the serving utilities.

Several factors motivated Congress to ratify BPA's role. Congress expected that the costs of developing a new resource would be much lower with BPA participation. This was because BPA could sign a contract to purchase the output of a proposed plant, and the developer could use that contract to secure less-expensive financing. It was also believed that BPA's involvement could facilitate the development of larger plants at a lower cost per kwh. In addition, Congress expected that by giving BPA the authority to acquire resources, BPA would be able to spread the benefits of federal power more widely through the Region—BPA could "grow the pie" to be divided up among the Region's preference utilities, investor-owned utilities, and DSIs. Indeed, the Act had a five-year phase in period for new rates and the new exchange program with the Region's IOUs, that was designed to let the economic benefits of BPA's backing of power plants kick in.

In passing the Act, Congressman Moorhead of California had warned: "I am concerned that this Council, mandated to consider conservation first and conventional generation last, may succumb to a no-growth philosophy. This would be most unwise, since the region's past inability to build new generation has been a major factor in the present shortage."[20] Things happened pretty much as he warned.

While BPA had forecast shortages for years before passage of the Act, after passage of the Act, BPA proclaimed a surplus, leading some to suspect that its claims of deficit had been overstated all along. As a result, BPA spent its first ten years after the Act focused on conservation, canceling construction of nuclear power plants, and disposing of surplus power instead of exercising its new acquisition authority.

BPA's acquisition of resources was supposed to be consistent with the Council's power plan,[21] and the Council's primary focus became conservation. Indeed, the first power plan issued in 1983 called for half of the Region's load growth to be "served", or not served, to be exact, with conservation, and urged BPA to sell additional power to the politically-powerful IOUs so as to excuse them from the need to build additional plants for their rapidly-growing load.[22]

It was not until ten years after the Act, in 1990, that BPA finally adopted a "pilot program" to secure additional resources. BPA issued a Request for Proposals in 1991 for 300 aMW of firm energy.[23] In 1992, BPA selected the Tenaska project, a 248 megawatt natural gas-fired plant, as the most cost effective from over 102 proposals, totalling 5,209 aMW of generation.[24] BPA then spent two years negotiating a contract that its own analysts warned was unduly generous: it provided continuously escalating prices for twenty years.

In 1995, after the construction was in the latter stages, BPA repudiated the contract. Tenaska sued for breach of contract, and won. After spending tens of millions of dollars in legal fees, BPA wound up paying roughly $340 million in damages. BPA then turned around and sold the plant to a Canadian company for $25 million. Even today, though it has been clear for more than two years that electricity supply is a problem, BPA is still not signing agreements to acquire resources of any significance.

The Special Role of the DSIs under the Northwest Power Act

Because Columbia River streamflows are highly variable, the amount of electricity sure to be on hand is lower than the average amount of energy generated. An inherent advantage of hydropower is the ability to store energy at no cost, and release water when needed to generate electricity. Thus over decades of operations, and with greater coordination, BPA eventually perfected the art of “firming up” power that would otherwise have to be dumped on the market at nonfirm rates. This provided significantly higher financial benefits to BPA.

The DSI plants came to provide a market for such power, in particular one-quarter of BPA's sales to the DSIs, called the "top quartile". And additional quarter could be interrupted by BPA as reserves against power plant failures. And an additional quarter could be interrupted to cover transmission problems that would interrupt seasonal imports from California. The value of these interruption rights was shared between the DSIs and the rest of the Region pursuant to the Northwest Power Act, which directed BPA to give credit to the DSIs in setting rates for "the value of power system reserves made available to the Administrator through his rights to interrupt or curtail service to such direct service industrial customers".[25]

The Northwest Power Act formalized and locked in relationships that had emerged in BPA contracts, directing BPA to enter into new twenty-year contracts with preference customers, investor-owned utilities, and DSIs, and established detailed rate directives designed to control the prices BPA charged to each customer group. BPA was obligated to meet the needs of preference customers at the lowest rate, primarily based on the cost of BPA's hydropower resources, and to sell power to the DSIs at a somewhat higher rate.

Indeed, the DSIs were essentially forced to sign the new contracts with BPA, because Congress foreclosed, as a practical matter, their ability to purchase from other suppliers. Congress did this by creating a special class of customers called "New Large Single Loads", and directing BPA to charge its higher, "New Resource" rate for such loads, whether they were served by public or private utilities. The legislative history of the Northwest Power Act confirms that Congress’ principal purposes in doing this were to encourage the DSIs to take the new BPA contracts, and to ensure that the Pacific Northwest could not lure new businesses away from other, higher cost areas of the country.[26]

Now, as BPA seeks to throw the DSIs off the BPA system, they can't even get service indirectly from their local public utility districts. If they do so, BPA will raise the rates to those public utility districts for the power they sell to the DSIs because BPA will claim that the DSIs are New Large Single Loads.

For the first five years after passage of the Northwest Power Act, BPA was directed to use the profits earned from the DSIs to offer a "Residential Exchange"

program to the residential and small farm customers of the Region's investor-owned utility customers. Under this program, Regional IOUs could require BPA to buy their power at their Average System Cost, expected to be higher than BPA's costs, and to buy an equivalent amount of power at BPA's lower, cost-based rates. As the Supreme Court explained, "[b]ecause this exchange program essentially requires BPA to trade its cheap power for more expensive power, it is obviously a money-losing program for BPA. The Act expressly contemplates that much of the cost of this program is to be covered by power sales to DSIs, which pay a considerably higher price for power than other users."[27]

Fish Follies De-Rate the Hydrosystem

The rising political power of the environmental movement produced some of the least defensible things BPA has done. The fish and wildlife provisions of the Northwest Power Act are, like most environmental laws, a confused mess. On the one hand, Congress advised that the Act was not intended to impose new substantive obligations on BPA and the other federal agencies. On the other hand, fish advocates had convinced Congress to mandate that the Council's fish and wildlife plan "provide flows of sufficient quality and quantity between [the dams] to improve production, migration and survival of [anadromous] fish".[28]

Throughout the 1980s, fueled by ever-increasing sums of money from BPA, an army of fish biologists refined their theories that the dams were exterminating Columbia River salmon, and that the salmon themselves were endangered. By 1991, the first of many salmon runs were listed as endangered under the Endangered Species Act, though there seems little doubt that the real "species" were in no danger whatsoever—all branches of the salmon family are abundant in the world. The Endangered Species Act is so vague, however, that any particular local group of animals can be listed or delisted virtually at will.

Fish advocates stepped up their demands, and commenced a series of lawsuits, which the Justice Department failed adequately to defend. With the advent of the Clinton/Gore Administration, BPA and the other federal agencies generally capitulated to the fishery agency demands even when they won the lawsuits. By 1994, BPA was being saddled with roughly half a billion dollars a year in "fish" costs that produced virtually no fish.

Running the river "for fish" began to severely constrain the flexibility of the hydrosystem, as fish bureaucrats demanded that water be released downstream at times when it was not needed for power generation, and reservoirs that formerly held water in reserve for winter generation were emptied before winter. Over 85% of water storage flexibility was dedicated to fish operations, the firm capacity of the hydrosystem was de-rated by about 10%, and nonfirm flexibility was virtually eliminated.[29] Some of BPA's programs, like changing reservoir releases in Montana and Canada to try and create more Idaho salmon, cost upwards of $20 million a fish—if they have any effect at all.

The loss of operational flexibility affected the aluminum companies, because BPA began to interrupt their power to support fish operations. Indeed, with the ESA listings BPA simply "lost the capacity to serve 25 percent of its DSI loads under the 198[1] contracts"[30] The companies complained that their contracts required BPA to preserve the "expected average availability" of power notwithstanding changes in operations of the hydrosystem, and to use "best efforts" to provide that power. BPA refused to do so, and the DSIs began to look upon BPA as an unreliable business partner.

As the fish follies destroyed the structure established by the Northwest Power Act by destroying the historic bases of BPA's ability to serve the DSIs, many attacked the DSIs on the theory that they should be driven from the Region. Properly understood, the loss of traditional means to serve the DSIs should not be grounds for their extermination, but rather for treating them like any other regional industries, free to purchase power without punitive "New Large Single Load" rates.

By 1999, increasingly uncertain fish costs—including, potentially, the cost of removing the four Lower Snake River Dams—caused BPA to promise to raise rates to build up a $1.4 billion cash reserve that many in the Region feared would constitute a dam-busting fund.[31] Former Senator Gorton amended the Northwest Power Act in a minor way, so as to prevent BPA from collecting excess funds.[32] But BPA took the position that the law changed nothing, and continued to put the same amount of fish and wildlife costs in its rates.

Last year, BPA spent roughly $600 million on spill for fish, despite evidence that most of the spill does not benefit fish, and may injure them. BPA has funded an entire of river of junk science designed to show that expensive programs are needed for salmon recovery, while the salmon remain the only so-called "endangered species" that you can buy and eat for $3.00 a pound. Huge amounts of resources are extracted from the Region's electric ratepayers to provide miniscule or non-existent benefits for commercial fishermen. And given that BPA pays anywhere from thousands of dollars a fish to tens of millions of dollars a fish, this is perhaps the most inefficient transfer of public resources ever devised by the Federal government.

The Death of Accountability

A firestorm of litigation began arising out of WPPSS and BPA's initial decisions under the Act, which resulted in the death of legal accountability for policy decisions concerning electric power. All of the public agencies were permitted to repudiate their WPPSS contracts for the fourth and fifth nuclear plants. Over time, the United States Court of Appeals for the Ninth Circuit, aided and abetted by doctrines of administrative law from the Supreme Court, developed what it called "deference" to BPA decisions.

The general theory was that if laws were vague, then BPA should be allowed to interpret them in virtually any way it chose, particularly in the area of rates and ratemaking. Over time, the only constraint upon BPA's behavior has become political, prompting it to do more and more outrageous things, both to manipulate public opinion,

and to respond to the will of politicians. BPA's casual disregard of the design of the Northwest Power Act is now widely recognized, and rationalized on the ground that the law is "increasingly out of synch with the regional demands upon BPA and the requirements of the evolving competitive marketplace".[33]

The demands of the politically-powerful now trump the law, an increasingly common problem with all federal agencies. And the agency itself has begun to exercise arbitrary power without regard to the demands of politicians. BPA now frequently demands provisions in its contracts forbidding customers from publicly criticizing BPA, and demands that customers make contributions to a BPA-selected "public purpose" organization as the price of obtaining discretionary action from BPA.

The 1995 Contracts and the Stranded Cost Scare

By 1995, BPA's costs had risen to the point where long-term firm power was available on the market for rates lower than BPA was charging. BPA's customers began to look for alternate, lower priced supplies of power. Many public utilities reduced their purchases from BPA as fast as possible. For example, Public Utility District No. 1 of Clark County, Washington had cut its purchases from BPA by half by October 1, 1996, and down to just 10 average megawatts by August 1, 1997.[34]

BPA was anxious to retain DSI load, but also anxious to assure a guarantee of future revenues. Thus BPA insisted that the DSIs purchase power in the 1996-2001 period on "take-or-pay" contracts, under which they would be required to commit to a specified block of power, and pay for it whether they used it or not. The DSIs in turn insisted on the right to remarket the power in the event they did not use it.

The DSI contracts were highly controversial, because BPA and the Region's energy planners were in the grips of a fear that BPA's rising costs would cut its sales, producing what utility executives called "stranded costs". All of the utilities were in a panic that lower market prices would mean that many of their generating assets could no longer be run. All of them, including BPA, wanted to be able to charge their customers for the full cost of such assets, irrespective of their market value.

The DSIs had negotiated contracts back in 1981 that protected them against additional cost assessments, but many of BPA's other customers, particularly the public agencies, had failed to do so, and they were highly jealous of the DSI contracts. So they began a public campaign to vilify the DSIs for failing to pay their fair share of "stranded costs". The Governors of Oregon and Washington sought to prevent BPA from executing new contracts with the DSIs unless they imposed liability for "stranded costs", particularly WPPSS debt.[35]

At the same time, fearing that it might no longer be able to sell enough power to cover power generation costs—and the costs of BPA's ever-growing public benefits programs—BPA began a campaign to secure authority from Congress to charge "wire fees" to recover power costs in transmission rates. Legislation was necessary because a

long line of decisions from FERC had established that BPA was not allowed to recover generation costs through transmission rates applicable to non-federal power.[36] Thus BPA, through the Department of Energy, proposed legislation that would permit FERC to exempt it from the standard transmission rules.[37] Despite support from the Administration,[38] the concept eventually faded, in part because BPA found that 20% of its transmission customers could bypass any such fee.[39] As late as the summer of 1999, however, the "wire charge" concept continued to surface in draft legislation proposed by BPA.[40] By now, BPA's generating assets are recognized to be incredibly valuable, and not "stranded costs" at all. It was only the wasteful spending of BPA on non-power programs that temporarily concealed their value.

The knee-jerk response of BPA and its public agency customers to the perceived crisis from higher-priced BPA power was to demand that all historic customer classes be assessed surcharges—to keep BPA's rates down for the benefit of the public customers. Later, of course, when market prices moved above BPA's costs, BPA and the public customers would have the knee-jerk response of seeking to kill off the very customers they previously demanded remain subject to BPA charges.

The IOUs Milk BPA

Another result of BPA's rising costs and falling market prices was that benefits available under the Residential Exchange evaporated—utilities began to have Average System Costs that were closer to BPA's costs. More importantly, it became economically feasible for BPA temporarily to sell power to the IOUs and replace the power on the open market instead of buying power from the IOUs at the IOUs' Average System Cost—that being the "exchange" design of the Northwest Power Act. However, this deprived the IOUs of an above-market price for their own power, and threatened to drive up their retail rates.

The Region's IOUs, backed by the Region's Public Utility Commisions, claimed that BPA was "manipulating" the Residential Exchange program in the 1996 rate case. They sought legislation forcing BPA to continue to offer them hundreds of millions of dollars in subsidies for residential customers, notwithstanding the rate directives of the Northwest Power Act; it being an election year, Congress assented.[41] Notwithstanding the law, which remained on the books, the Conference Committee Report encouraged "Bonneville and its customers [to] work together to gradually phase out the residential exchange program by October 1, 2001".[42]

The Residential Exchange as provided in the Northwest Power Act had the virtue of only costing BPA the difference between its cost and the Average System Cost of utilities; it was power-supply neutral to BPA. As a result of the declining benefits, however, the Region's Public Utility Commissions had become convinced that power exchanges no longer offered benefits to the Region's residential and small farm ratepayers. So the Region's PUCs demanded that BPA offer real electricity to the IOUs, even though BPA did not have the power to do so.

The controversy over the DSI contracts and the Residential Exchange produced calls for a Regional process to address the future of BPA and its contracts. The Region's Governors appointed a Steering Committee to try and reach consensus about the future role of BPA in the Region. The result was a year-long process, ending in December 1996, called the "Regional Review".

The Governors' appointees produced a rough consensus that BPA should offer power "subscriptions" to its existing customers, with preference customers having first right to subscribe, but only for an amount of power up to their 1997-2001 levels. The DSIs and residential and small farm customers of IOUs participating in the Residential Exchange would have the opportunity to subscribe for power, but only up to 1997-2001 levels. Thus existing customers would not be pushed off the system by the load growth of other customers, or decisions by other customers to return load to BPA. Every customer group would get a fair share of low-cost BPA power, but limited to their then-present loads.

To the extent that BPA continued to exercise its resource acquisition authority to meet loads in addition to those that could be served with its then-existing resources, the Regional Review recommended that the customer that needed the resource pay the full cost: "BPA would not acquire resources to serve its customers' load growth except on a direct bilateral basis where the customer takes on all the risk of the acquisition".[43] In short, a customer would face a low-cost rate for its share of the then-existing Federal resource base, and a higher cost for additional power, a concept commonly called "tiered rates". The Regional Review also reached a consensus in favor of raising energy taxes to support increased public spending on conservation, low-income assistance, and fish and wildlife as a substitute for BPA including such costs in its cost-based rates.

BPA publicly agreed with the Regional Review's conclusion that it should not build new capacity, notwithstanding the statutory directives to assure an adequate supply of electricity. In the wake of the Review, observers concluded that "[n]ew merchant plants . . . are having a hard time finding someone to purchase their output in the face of this policy uncertainty."[44] As always, the problem remained the same: "weather driven changes in the amount of hydro generation cause the price of power in the market to vary to the point that a new merchant power plant may not be able to economically survive a series of wet years."[45]

The Energy Planners Fail To See Higher Prices Coming

The Northwest Power Act assessed electric ratepayers to fund a small army of planners and forecasters in the Northwest Power Planning Council and elsewhere, none of whom apparently foresaw today's rapid rises in electricity prices. In 1996, the Council forecast that "the region will experience generally stable electricity prices that will probably decline slightly in real terms".[46] The Council forecast stable natural gas prices as well.[47] And the Council recommended that the Region could save billions of dollars

by relying upon purchases from California and elsewhere rather than building new power plants.[48] In 1998, the Council reiterated each of these forecasts.[49]

Faced with a cyclical downturn in power markets, BPA entered into numerous long-term contracts to export power from the Pacific Northwest at depressed prices, without regard to its ability to meet the Regional loads when current contracts expired in 2001. Among other things, BPA sold hundreds of megawatts power to Enron, Avista, and the Bay Area Rapid Transit Authority.

A new Administrator, Judi Johansen, took over in June 1998. She followed the Regional Review's suggestion to offer "subscriptions" for Federal power, but picked and chose among the Review's recommendations in ways that did not work. The Review had carefully balanced limitations on BPA's resource acquisitions with limitations on the entitlements of the customer groups to the low-cost hydropower. Administrator Johansen removed all restrictions on the ability of the preference utilities to buy additional power at the lowest rates. She agreed to sell, rather than exchange, power to the IOUs. But she did not make any corresponding adjustment in BPA's resource strategy to come up with the power needed because of these decisions.

The "Power Subscription Strategy", issued in December 1998, promised to offer power rates "significantly below market and approximately equal for all customer groups".[50] The Strategy suggested that public customers would buy roughly 5500 megawatts, the IOUs would "be assured access to the equivalent of 1500 megawatts", and that BPA expected to be able "to serve all DSI load placed on it".[51] BPA hoped to buy additional short-term power to meet all of its commitments without raising its costs. The Strategy contained promises that BPA could not possibly meet.

By early 1999, BPA was beginning to forecast large deficits in its power supply, and the new Administrator appeared before the Power Planning Council to warn of the problem. But instead of offering leadership in the construction of new plants, she told the Council, in substance, that reliability was not BPA's concern, and urged the Council to study the issue.

Another year passed before the Council finally issued a report on the problem.[52] The Council confirmed that the Region now had a one in four chance of "not getting through the winter without a supply interruption", and warned that the deficit could be as large as "several thousand megawatts for a few days".[53] The Council also found that it was now too late to do anything about the problem: "given the lead times for the development of substantial amounts of new generating capacity, it seems clear that much of th[e needed] capacity will have to be met through voluntary load reduction where reducing load makes sense for both the end user and the system".[54]

The New Market and the Drive To De-Industrialize the Region

BPA's Subscription Strategy was developed in a context where BPA's biggest recent fear was that it would not be able to sell all of its power. As market prices soared, BPA continued to make many decisions largely as if nothing had changed. Perhaps because of the Tenaska fiasco, and lingering fears of unsold power inventory, BPA remained unwilling to make long-term resource acquisitions to serve the Pacific Northwest.

To make matters worse, BPA adhered to the decisions that significantly reduced the amount of low-cost hydropower it had to sell. In April 2000, Administrator Johansen amended the Subscription Strategy to offer at least 1,000 megawatts of actual BPA power deliveries, with another 900 megawatts of cash benefits.[55] The decision to supply actual power to the IOUs was characterized as a "settlement", though no lawsuit had been filed, so as to circumvent the design of the Northwest Power Act. The cash value of the "settlement" is several times greater than the Exchange program it supplants.

During the period of low prices, BPA had permitted the preference customers to diversify and purchase power elsewhere, yet had failed to include any contractual restrictions to prevent the publics from bringing the load back all at once when prices changed. Clark Public Utilities, for example, advised BPA that it would increase its power demand from 10 to 295 average megawatts commencing October 1, 2001.[56] BPA proceeded to conduct its rate case in the fall of 1999 and spring of 2000 on the assumption that the Region's public utilities would serve 1,500 megawatts of their own load after 2001, even though BPA knew then that market-priced power was going to be at least 50% higher than BPA rates.

Based on the false assumption that preference customers would buy much of their power somewhere else, BPA did nothing to acquire power to serve their load. BPA could have purchased much of the power to serve their load at reasonable prices, and, indeed, BPA did purchase much of the power needed to serve DSI load at reasonable prices. Almost immediately after BPA issued its rate decision in May 2000, the preference customers subscribed for 1500 megawatts more power than BPA had anticipated.

BPA now began to panic as market prices headed upward rapidly, and the cost of buying the extra 3,000 megawatts now forecast as needed to meet load began to exceed BPA's entire budget. Administrator Johansen suddenly departed in November 2000, and because senior VP of regulation and external affairs at PacifiCorp. The new Administrator, Steve Wright, had been BPA's Washington, D.C. lobbyist. BPA had come full circle, from an agency run by engineers who built things, to an agency run by political hacks who rationed out the declining benefits from decaying capital to political supporters.

The DSIs Offer A Solution To BPA's Problems

BPA proposed to cover the extraordinary cost of meeting its shortfalls through a "Cost Recovery Adjustment Clause", and began negotiations with its customers to design such a clause. BPA had promised, in writing, to amend the DSIs' power sales contracts

to let them DSIs cut back their power consumption to avoid these charges, and, after lobbying by the Region's public and private utilities, BPA repudiated its contract promise.

The Region's public and private utilities met secretly with BPA staff and designed rates that would raise the cost of all power consumed by an equal amount. This was a gross breach of the rules governing rate hearings, but by now everyone seemed to believe, probably correctly, that BPA was not accountable to law. They and BPA came up with the solution to BPA's power supply shortfall: design rates so as to turn off the aluminum companies and many other heavy industries. In effect, this imposed the costs of BPA's power shortfall caused by the larger, rapidly-growing preference utilities, which had abandoned BPA in 1995, upon those customers for whom power costs were important to their economic survival.

Since striking that deal, BPA operatives have scurried about the Region, signing up industrial and farm loads throughout the system for load reduction. The historic process by which BPA energized the Pacific Northwest is being reversed before your very eyes.

The DSIs responded by advancing the very consensus of the Regional Review: "tiered rates" for BPA power. Under the "tiered rate" proposal, a customer could get 75% of their allocation of BPA power at the low, May 2000 rates, and the other 25% of their power at market prices, whether through BPA or otherwise. This would have left the DSIs with roughly 1500 of the 2000 megawatts promised in the Subscription Strategy.

"Tiered rates", by raising the price for the last units of power consumed on the margin, are widely recognized as leading to more efficient use of electricity, and are employed by many other utilities in many countries. Tiered rates offer the best means of conserving power with the minimum economic losses to the Region, because many businesses that will be put out of business by higher average rates could cut their power usage by one quarter and stay in business.

But the Region's public and private utilities do not want tiered rates. Many of the larger preference utilities have negotiated the same contract provision that they are using to attack the DSIs: the contract right to resell any power not used at market rates, for a profit. There was no profit for these utilities in a tiered rate proposal, because any reductions in consumption their customers would achieve would come in the first 25% of market-priced power, and leave the utilities no opportunity to profit from the resale of this conserved power.

Politicians who see no further than the next election cycle apparently think that wiping out the energy-intensive businesses that are a backbone of the Pacific Northwest is a worthwhile enterprise it if will keep residential rates slightly lower. They argue that the employment provided by aluminum companies and other energy-intensive industries is small. In fact, the most recent study shows total employment benefits of 40,000 jobs from the aluminum industry alone, providing $1.5 billion in personal income, and $141

million in state and local taxes.[57] This level of economic activity is not small to the counties who host aluminum and other plants, where plant jobs are some of the highest-paying jobs available.

The government experts who claim that shutting down energy intensive industries will cause no harm to the Region's economy ought to be regarded with the same skepticism as the government experts who first decided we needed ten nuclear plants by the mid-eighties, and then told us that market prices would be lower than BPA power. The government has both failed to build power plants to keep the lights on, and promoted environmentalism so that no one else can build the plants either.

Whither BPA?

Because electricity is an essential commodity for economic survival, government control of access to electricity exercised by partisan politicians means that political considerations will determine which economic entities survive and which die. As industries targeted for extinction as a matter of federal politics and policy, the most important reform of BPA is one that gets politics out of BPA's power allocation decisions. More generally, without significant reform, BPA will continue its evolution toward an all purpose taxing and spending agency accountable to no one

The breakdown of political consensus concerning allocation of BPA benefits poses larger threats than de-industrialization. Many believe that without a concerted Regional effort to reform BPA, the "policy and leadership vacuum in the region will leave the federal government to decide how best to control the operations of the Columbia River system. This will result in the Federal government directing the system in ways that meet the interests of the Federal government instead of the region."[58] More precisely, BPA will be directed in ways that meet the interests of whatever crowd exercises power inside the Beltway, rather than the interests of the Region.

A recent report by the Northeast-Midwest Institute challenges *any* federal role in the electric business, noting that the initial federal goal of rural electrification has been largely accomplished. [59] Many interests seek to charge market-based prices for all Federal power, and abolish Regional preference entirely. A move to market-priced BPA power would have far worse economic effects than merely wiping out electricity-intensive industry, as the Region's entire infrastructure is geared to run at lower electricity costs.

There are many options available for reform of BPA, and many paths lead to improvement. One option would be to remove the role of the federal government entirely, by having BPA's customers and perhaps other entities purchase BPA, with or without its generating assets, and run it as a large cooperative. Some have suggested that the more controversial lower Snake River hydropower projects be spun off and sold to Pacific Northwest tribes whose treaty rights are affected by operation of the projects, as a final settlement of all treaty disputes. While there are many political hurdles to such a

plan, financial hurdles are not significant—investment banks have confirmed that the purchase could be financed.

Conclusion

The New Deal dream was that impartial, expert administrators, freed from traditional legal and Constitutional constraints, could bring immense public benefits to citizens of the United States. For a time, the dream was realized. But now BPA and other New Deal agencies are in the hands of those whose conception of the public interest is far removed from that of the ordinary citizen. The rise of such unaccountable, yet highly-politicized bureaucracies is one of the greatest threats to the Nation. The citizens of the Pacific Northwest cannot, by themselves, save the Nation. But they can save the hydropower assets of the Pacific Northwest, and put their management back on a path that will continue to bring immense public benefits to the citizens who have been paying for the assets for over sixty years.

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[1] Final Environmental Impact Statement: The Role of the Bonneville Power Administration in the Pacific Northwest Power Supply System, at I-11 (DOE December 1980).
[2] 16 U.S.C. § 832e.
[3] V. Springer, *Power and the Pacific Northwest: A history of the Bonneville Power Administration* 47 (BPA 1977).
[4] G. Tollefson, *BPA & The Struggle For Power At Cost* 259 (BPA 1987) (quoting BPA employee Sam Moment)
[5] *Power and the Pacific Northwest* at 54.
[6] *BPA and the Struggle for Power at Cost* at 284.
[7] *Id.* at 336
[8] P.L. 88-552, 78 Stat. 756 (August 31, 1964).
[9] Role EIS, at I-13.
[10] *BPA and the Struggle*, at 353.
[11] *Id.*
[12] P.L. 93-454, 88 Stat. 1376 (Oct. 18, 1974).
[13] *BPA and the Struggle*, at 362
[14] *Id.* at 365.
[15] *Id.* at 375.
[16] *Id.* at 379.
[17] 16 U.S.C. § 839(2).
[18] 16 U.S.C. § 839b(a)(1).
[19] 16 U.S.C. § 839b(e)(2).
[20] *Congressional Record* H9849 (daily ed. Sept. 29, 1980).
[21] 16 U.S.C. § 839d(a)(1).
[22] *BPA and the Struggle*, at 405.
[23] Tenaska EIS, § S.3.
[24] *Id.; see also* http://www.tenaska.com/Projects/Frederic/frederic.htm.
[25] 16 U.S.C. § 839e(c)(3).
[26] H. Rep. No. 96-976, Pt. 1, 96th Cong., 2d Sess. 51 (May 15, 1980).
[27] *Aluminum Co. of America v. Central Lincoln People's Utility* District, 467 U.S. 380, 399 (1984) (citing H. Rep. No. 96-976, Pt. 1, at 29 (1980))
[28] 16 U.S.C. § 839b(h)(6)(E)(ii).
[29] G. Derfler, "Should the Pacific Northwest Regain Control of the Columbia River?", Preliminary Report to the Four State Legislative Compact, April 7, 2000 ("Derfler Report"), at 13.

[30] Derfler Report, at 13.
[31] J. Barnett, "BPA plan could backfire, Senator says", *The Oregonian*, June 10, 1999.
[32] 16 U.S.C. §839e(n).
[33] Derfler Report, at 29.
[34] P. Russell, "Clark, BPA Settle White Book Lawsuit, Reach Power Agreement", *Clearing Up*, July 8, 1996, at 7.
[35] Letter, J. Kitzhaber to H. O'Leary, Aug. 31, 1995; Letter, M. Lowry to W. Clinton, Aug. 23, 1995.
[36] *See, e.g.*, *Order Confirming and Approving Transmission Rates*, 20 FERC ¶ 61,142, at 61,314-15 (Aug. 3, 1982) (citing 16 U.S.C. §§ 838g-838h).
[37] *See* Electric Power Alert, Jan. 8, 1997 (reproducing draft DOE bill dated Nov. 26, 1996).
[38] Administrator Hardy testified before the Subcommittee on Water and Power of the House Committeee on Resources on June 12, 1997 that "Bonneville needs and the Administration supports a contingent stranded cost recovery mechanism, to help avoid burdening the United States taxpayers, who under law stand last in the line of Bonneville creditors".
[39] Transmission Surcharge Study briefing, Nov. 5, 1997.
[40] *See, e.g.*, July 22, 1999 Northwest Delegation staff draft "Northwest Chapter" legislation.
[41] P.L. 104-46, 109 Stat. 420-21 (Nov. 13, 1995) (setting $145 million subsidy for 1997).
[42] H. Rep. 104-293, 104th Cong., 1st Sess. 92 (Oct. 26, 1995).
[43] *Final Report: Toward a Competitive Electric Power Industry for the 21st Century* 5 (Dec. 12, 1996).
[44] Derfler Report, at 20.
[45] *Id.*
[46] Draft Fourth Northwest Power Plan, Council Doc. No. 96-5, at 5-4 (NWPPC May 23, 1996)
[47] *Id.* at 5-6.
[48] *Id.* at 5-12.
[49] Revised Fourth Northwest Conservation and Electric Power Plan, Council Doc. No. 98-22.
[50] Power Subscription Strategy: Administrator's Record of Decision 9 (BPA Dec. 1998).
[51] *Id.* at 13, 15.
[52] Northwest Power Supply Adequacy/Reliability Study Phase 1 Report, Council Doc. No. 2000-4 (NWPPC March 6, 2000).
[53] *Id.* at 3.
[54] *Id.* at 4.
[55] *Power Subscription Strategy: Administrator's Supplemental Record of Decision* 14-23 (BPA April 2000).
[56] *See* BPA Press Release, May 25, 2000 (http://www.bpa.gov/Corporate/KCC/nr/01nr/nr052501x.shtml)
[57] D. Conway, Economic Impact Studies, Dec. 2000 (http://www.bpa.gov/Power/PL/AluminumStudy/AluminumStudy.shtml)
[58] Derfler Report, at 22.
[59] R. Munson, *Rethinking Bonneville: Why BPA Must Be Reformed* (Northeast-Midwest Institute 2001).