

MEMORANDUM

TO: Board of Commissioners
FROM: Power Contract Negotiating Team
RE: History of Contractual Relationships Between Chelan PUD and Alcoa
DATE: October 15, 2007

The history of how and why Alcoa came to this community is important and puts these current negotiations into a historical context.

In writing this memo, the team referenced a 1972 booklet written by Hu Blonk, a Wenatchee World reporter, and a paper written in 1975 by Paul Williams of John Nuveen Company (a financial firm involved in the financing for the various projects during the 1950's and later). Other historical and current information was also used.

Rock Island and Alcoa's arrival. 1940s to 1957

In the middle to late 1940s, Chelan PUD began working to acquire the Rock Island and Lake Chelan hydro projects. The Rock Island project was owned by Puget Sound Power & Light (Puget) at the time. During that same time the City of Seattle was threatening to not renew Puget's franchise to operate within the city limits and making efforts to purchase Puget's distribution system located in the city. As part of that discussion, Seattle was insisting that it had the right to buy the Rock Island project because the project would produce the same amount of power needed by the city to serve the distribution system it was buying from Puget. About this same time, Tacoma was demanding some of Puget's power dams on the coast. These events caused both Chelan PUD and Puget to be concerned about the fate of the Rock Island project. In order to prevent an outside takeover, Chelan PUD instituted a condemnation action and "Puget did not object to this action because in the past Chelan PUD had always shown and acted in good faith in negotiations and discussions with Puget." (Quotation from Blonk booklet.) This action by Chelan PUD put its legal position ahead of Seattle's and Tacoma's potential legal claims. This all occurred at a time when Rock Island was only about 30-percent complete.

Before Chelan PUD could acquire Rock Island, the Korean conflict occurred. It brought on a nationwide campaign to develop more power to produce aluminum and other metals for war purposes. Chelan PUD Commissioner Kirby Billingsley had heard from the federal government that several aluminum companies were looking for a site near Rock Island knowing that, if Chelan PUD's negotiations or condemnation case were successful, the hydro project could be completed and power would be available. In late 1949/early 1950, a decision was made by Chelan PUD to work with Alcoa. There was

much concern at the time because there was a large segment of people in the federal government, including the Bonneville Power Administration, who thought that Rock Island should be part of the federal system. The federal government actually served notice that it was going to take over the project if someone else did not develop the project to full power production.

As a result, Chelan PUD, Puget and Alcoa executed a complicated transaction whereby Chelan PUD leased the unfinished portion of the dam from Puget to increase power output. At that time, there were six open slots which were leased by Chelan PUD. Commissioner Billingsley noted that this arrangement brought tax revenues and jobs to Chelan and Douglas counties which would have been lost otherwise.

Six new generators were installed as a result of this agreement between Chelan PUD, Alcoa and Puget. This agreement was completed quickly because of the time it would take Alcoa to build its aluminum plant. The investment by Alcoa in 1951 was approximately \$58 million for the facility. Alcoa constructed a plant with three pot lines. Chelan PUD commissioners wanted the District to be the “tool to achieve new industry” for the area. The goal was to develop payrolls in the community. Alcoa built its plant, adding a new cornerstone to the economy of the local area. Puget retained ownership of the dam. The agreement served as power sales agreement as well.

During this time frame, Rock Island project power was used for the initial operation of the Alcoa plant. As BPA power became available, Chelan PUD and Puget entered into negotiations about Rock Island. In 1956, Chelan PUD acquired the ownership interests of Puget in Rock Island and entered into the power sales arrangement with Puget.¹ By this time, the Alcoa Wenatchee plant was fully supplied by BPA energy. Alcoa continued to purchase power exclusively from BPA until 1961.

Rocky Reach and Alcoa’s continued operation. 1957 to 1992

The site of the Rocky Reach project was first identified by the Army Corps of Engineers. In 1954 Chelan PUD filed an application with Federal Power Commission for a permit to explore the possibility of financing and constructing a hydro project at that vicinity. Puget advanced the initial monies for the preliminary engineering on the Rocky Reach development. When financing was originally sought, Puget was the sole purchaser of power from Rocky Reach. Several banks and insurance companies withdrew from the

¹ The existing contract with Douglas PUD that provides them with a 2.77% share of Rocky Reach output (increasing to 5.54% share in 2011 with options to extend through 2061) was agreed upon during this same time frame. The history of this contract relates to the history of Rock Island and Rocky Reach. A letter from Howard Elmore (General Manager 1969 – 1980) documents that when Chelan PUD was ready to go to the bond market to finance the acquisition of Rock Island, Douglas PUD began to press a position that because the Rock Island project was located in both Douglas and Chelan counties Douglas PUD should get an interest in the Rock Island project. Douglas PUD filed a petition in court seeking that relief. This was bad timing for Chelan PUD’s financing. To settle this claim, Chelan PUD agreed that Douglas PUD would receive a portion of the Rocky Reach output when the project was built. In return, Douglas withdrew its opposition to Chelan PUD’s negotiations to acquire the Rock Island project. The actual contract with Douglas PUD was signed in 1976 formalizing a 1957 letter of agreement.

financing for various reasons, including the fact that Puget was the only purchaser. As deadlines approached, Chelan PUD decided to add additional power purchasers. Within a few weeks, it was possible to add Alcoa, Pacific Power and Light, Portland General Electric and the Washington Water Power Company. This diversification allowed the financing to go forward.

The power sales agreement with Alcoa for a 23% share of Rocky Reach output was signed November 14, 1957, for a term expiring on October 31, 2011 (50 years after Rocky Reach went into commercial operation). This contract required that the energy be used in Alcoa's operation of the Wenatchee Works. Alcoa used this energy to displace purchases from BPA. Amendments were signed when four additional units were added to Rocky Reach and the percentage share of increased output sold to Alcoa remained at 23%. Alcoa built two additional pot lines and increased its BPA purchases. Rocky Reach power was used to run the two newer pot lines.

In 1992 an Industrial Power Sales Agreement was executed between Chelan PUD and Alcoa containing : (1) An assignment of the Rocky Reach power by Alcoa to Chelan PUD in which Chelan PUD agreed to deliver to Alcoa "Rocky Reach Replacement Power" (equivalent to the 23% share) and supplemental/additional power; and (2) an Industrial Power Sales Contract which included the provision for 1995 Energy and 2000 Power totaling 42 aMW to be purchased at the average industrial rates charged to other industrial customers. The 1992 Industrial Power Sales Agreement was replaced by a Restated Industrial Power Contract in April 1996.

These agreements did not include any minimum operating criteria nor did they specifically address the potential of a shutdown. These contracts gave additional market access to Alcoa, which Alcoa used to displace BPA purchases for one of the three original pot lines.

During the 1990s, Alcoa modernized and improved the Wenatchee plant.

Western Energy Crisis. 2001 and 2004 Agreements to present

The 2001 Agreement provided for a shutdown of the Wenatchee plant. It further provided that during any shutdown period, the District would sell the Rocky Reach Replacement Power on the market. The 2001 Agreement required that Alcoa continue to employ its 400 workers, and they did so in upgrading the facility as well as allowing those workers to participate in community activities. The concept was to build a fund using the energy sales at high market prices. The fund would be used to build/create another source of energy so that when Alcoa reopened the Wenatchee Works, there would be more energy available to them for a larger operation. The proceeds were then used (1) to pay the costs of producing the energy under the existing contract; (2) to pay the District an administrative fee; (3) to pay Alcoa the sum of \$4,333,000 per month, to the extent available from the proceeds, for the ongoing salary obligations; and then (4) any remaining funds would be placed in a "Construction Fund."

This 2001 Agreement was approved by the Board of Commissioners pursuant to Resolution No. 01-11830.

Soon after the execution of this contract, the market price of energy fell. The Construction Fund never came to fruition. There was money accumulated (approximately \$13 million) that was used in 2004 to help defray Alcoa's startup costs in 2004.

The 2001 Agreement contained a provision recognizing that the parties were in discussions concerning a new power sales agreement commencing in 2011 for a period of time through 2036 (25-year contract) for 20% of the hydropower resources of Chelan PUD (all three projects) plus a portion of new resources that were expected to be financed by the Construction Fund.

The Wenatchee Works remained shutdown until mid-2004. At that point in time, Alcoa made the decision to restart two pot lines at Wenatchee Works. Alcoa terminated the 2001 Agreement, reinstating the 1996 Industrial Power Sales Agreement. Alcoa and the District negotiated changes in a 2004 Restated and Amended Industrial Power Sales Contract effective October 1, 2004. This 2004 Agreement was approved by the Board pursuant to Resolution No. 04-12621. There were many reasons for this 2004 Agreement, including updating information, clarifying provisions and adding certain obligations/responsibilities of the parties. There were no employment or operation guarantees included. However, there was discussion at the time of its approval of protecting the jobs due to a contract provision that allowed some accumulation of money in a credit account that could only be used to operate the Wenatchee Works. Specifically, any power not used to operate Wenatchee Works would be sold and placed in a credit account that could be used by Alcoa to pay costs of power for the Wenatchee Works.

This 2004 Agreement also included a provision about a new power sales agreement (20% of Rock Island and Rocky Reach) and both parties agreed to negotiate in good faith the terms of that post-2011 agreement.