

BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF THE *Utilities Commission Act*, RSBC 1996, c.473

and

Filing by British Columbia Hydro and Power Authority
of 2007 Electricity Purchase Agreement with Alcan Inc.

BCUC Project No. 3698475

RESPONSE ARGUMENT OF INTERVENORS
B.C. SUSTAINABLE ENERGY ASSOCIATION
SIERRA CLUB OF CANADA (B.C. CHAPTER), AND
PEACE VALLEY ENVIRONMENT ASSOCIATION (“BCSEA, *et al*”)

December 12, 2007

Introduction

1. These are BCSEA, *et al*'s¹ submissions in response to the final written arguments of the intervenors District of Kitimat, B.C. Old Age Pensioners Organization, *et al.* ("BCOAPO"), and CAW Local 2301, each of which is dated December 10, 2007.

District of Kitimat

2. The DOK says that the 2007 EPA is not in the public interest and that the Commission should not accept the 2007 EPA for filing under s.71 of the Act.²
3. In this response submission, BCSEA, *et al* address DOK's argument that "the 2007 EPA creates incentives for the smelter modernization project to be scaled back, delayed or possibly even abandoned." BCSEA, *et al* rely on, and respectfully refer to, the points made in their Final Argument concerning the price comparators used by BC Hydro to justify the 2007 EPA.
4. BCSEA, *et al* make two main points in response to DOK's argument against the 2007 EPA on the 'other public interest factors' ground.
5. First, woven inextricably through the DOK final argument is the assumption is that it is not proper, in law or in public policy, for Alcan to sell any Kemano power except Kemano power that is surplus to the maximum possible consumption of power by the Kitimat aluminum smelter.
6. With respect, that assumption is not correct. As a matter of law, DOK's arguments based on this assumption were rejected by the B.C. Supreme Court.³ As a matter of policy, DOK's argument that the Commission should not approve long-term firm energy contracts from industrial producers who have built generation facilities to

¹ The abbreviations in this submission are the same as in BCSEA, *et al*'s December 10, 2007 Final Argument.

² DOK Memorandum of Argument, paras.1, 6.

³ *District of Kitimat and Wozney v. Minister of Energy and Mines et al*, 2007 BCSC 429.

support their industrial operations was rejected by the Commission in the LTEPA+ Decision.⁴

7. Second, the lynchpin of the logic of DOK's position is its theory that "modernization is merely a mirage Alcan is using to support a power sales agreement that would actually make modernization less likely."⁵
8. In the 'mirage theory,' Alcan *has no present intention* to construct and operate a modernization project. This is why DOK states very carefully that it "supports the stated intention of Alcan to modernize its smelter"⁶ – but DOK *never* states that it supports 'Alcan's Modernization Project.' For DOK, 'Alcan's Modernization Project' is a "mirage," a deceptively fatal illusion, not a real, physical construction project.
9. For DOK, the fact that "Alcan has adamantly refused to commit in a meaningful and binding way to the modernized smelter"⁷ is explained by Alcan's lack of an *actual* commitment to *actually* build a new smelter. DOK states, "The Alcan panel expressed great optimism that the modernization project would proceed, but the evidence is that it does not have even conditional approval from the Alcan Board, let alone the Board of Rio Tinto."⁸
10. DOK's position is that actual modernization of the smelter will *not* proceed, regardless of the fate of the 2007 EPA. This is clearly and, BCSEA, *et al* would say, accurately, reflected in DOK's statement that "The reaction to the 2007 EPA in the north-west as evidenced by the positions taken by the District and other intervenors and interested parties such as the CAW, KTIDS and the City of Terrace depends on the assessment of the likelihood that the modernized project will proceed."⁹ DOK, alone among the parties it mentions, opposes approval of the 2007 EPA 'full stop' –

⁴ LTEPA+ Decision, p.30. (Order G-176-06, Reasons for Decision dated February 2, 2007.)

⁵ DOK, para.63, underline added.

⁶ DOK, para.60, underline added.

⁷ DOK, para.61.

⁸ DOK, para.61, underline added.

⁹ DOK, para.59, underline added. Note the avoidance of the term "Modernization Project."

reflecting DOK's conviction that the "modernized project" will not proceed. In significant contrast, the position of the CAW is not opposition to the 2007 EPA 'full stop,' but in support of a 2007 EPA with the addition of a "Project Agreement." The CAW's position reflects a determined expectation that the modernization of the smelter *will* proceed and a desire for guarantees to ensure that it does.

11. DOK's objection to the 2007 EPA is that it "provides significant incentives for Alcan to not build the modernization plant" and instead to "Divert Industrial power" for "power sales rather than smelting."¹⁰
12. It is important to note that DOK acknowledges that if the 2007 EPA is approved then Alcan's incentive to sell power rather than proceed with modernizing the smelter is determined by the Tier 2 price, not the Tier 1 price.¹¹ And, DOK backs off on the certainty of its disincentive argument regarding the Tier 2 price: "...Alcan would not proceed with the new smelter project if it had to pay the Tier 1 and quite possibly the Tier 2 price for the electricity the smelter requires."¹²
13. It is also notable that DOK does not directly argue that the Tier 2 price is above Alcan's opportunity cost (in the sense of the price Alcan could expect to receive for Kemano power sold to a third party or to BC Hydro not under the 2007 EPA.)¹³
14. DOK *does* cite two mechanisms by which it argues the 2007 EPA creates an incentive to 'sell not smelt' Kemano power.
15. First, DOK states that "The 2007 EPA eliminates the complexities of securing transmission and the required permits for what would be an expensive product to sell to any party other than BC Hydro."¹⁴ DOK does not especially emphasize this

¹⁰ DOK, para.59.

¹¹ DOK, paras.64-65.

¹² DOK, para.65, underline added.

¹³ If it were the case that the Tier 2 price was higher than Alcan's opportunity cost in terms of alternative sales opportunities then it could be argued that the 2007 EPA provides a higher incentive to 'sell not smelt' Kemano power than would exist in the absence of the 2007 EPA. This is the argument that DOK does not make.

¹⁴ DOK, para.66.

argument, presumably because if the 2007 EPA was cancelled Alcan would have to incur these costs anyway, in order to sell Kemano power to third parties or BC Hydro not under the 2007 EPA pursuant to the ‘mirage theory’ that that is Alcan’s real intention.

16. The second mechanism, the important one, is what DOK calls “the water rental rate risk.” DOK states:¹⁵

The 2007 EPA also eliminates the water rental rate risk Alcan would face if it simply abandoned or significantly reduced its smelting capacity in order to sell power to out-of-province parties – i.e., the risk that this or some future government would raise water rental rates to capture the value of the water resource that is no longer being used to benefit British Columbians.

17. This is the argument that completes the ‘mirage theory.’ The argument is that the problem with the 2007 EPA is that it obscures the need for, and therefore impedes, intervention by the government – “this or some future government” – aimed at thwarting Alcan’s true intention of selling *all* the Kemano power.¹⁶
18. While this theory has a certain internal logic, BCSEA, *et al* respectfully submit that the factual basis for it is completely unproven.

BCOAPO

19. BCOAPO urges the Commission to *accept* the temptation – that BC Hydro *discourages* the Commission from accepting – “to reject the 2007 EPA but indicate that it would become acceptable to the Commission if it contained a condition that BC Hydro’s obligation to buy would cease if Alcan does not proceed with the modernization project.”¹⁷
20. BCSEA, *et al* respectfully submit that there are four flaws in BCOAPO’s argument.

¹⁵ DOK, para.66, underline added.

¹⁶ For example, DOK refers to “the potential risk of increases to [Alcan’s] water rental rates if it embarked on such sales.” [para.49.]

¹⁷ BCOAPO, Final Argument, p.1, quoting BC Hydro Final Argument, para.101. .

21. First, under the heading “Smelter Modernization”¹⁸ BCOAPO asserts, without reference to any evidence, that the 2007 EPA “could produce a catastrophic impact on the Kitimat region’s economy if it incents Alcan to use the output of the Kemano facility entirely for electricity sales.”¹⁹ BCOAPO also refers to “large socioeconomic impacts,”²⁰ “the unintended consequence of a community losing its economic engine,”²¹ and “doing what they can to assure the continued economic viability of Kitimat.”²² With respect, BCOAPO makes no attempt to show how approval of the 2007 EPA would lead to these catastrophic outcomes.
22. Second, BCOAPO calls for the Commission to cancel the 2007 EPA unless Alcan legally commits itself to complete the Modernization Project – without *considering* the consequences for the Modernization Project and the economy of the Kitimat region in the event Alcan were to decline to make such a legal commitment.²³
23. Alcan has said that the filing of the 2007 EPA is a prerequisite for moving forward with the Modernization Project. Ironically, nothing is more likely to “incent” Alcan to abandon the Modernization Project and to “use the output of the Kemano facility entirely for electricity sales” than cancellation of the 2007 EPA.
24. In this context, it is incongruous that BCOAPO states that “the economic viability of the whole region is at stake depending on whether Alcan commits to maintaining its aluminum smelter operations (which undisputedly depends in turn on the modernization project proceeding.)”²⁴ If “the economic viability of the whole region is at stake” depending on the modernization project proceeding then it would seem highly imprudent to cause the cancellation of the 2007 EPA which is a prerequisite for the modernization project to proceed.

¹⁸ BCOAPO, pp.15-17.

¹⁹ BCOAPO, p.17.

²⁰ BCOAPO, p.16.

²¹ BCOAPO, p.16.

²² BCOAPO, p.15.

²³ There is no evidence suggesting that Alcan would be willing to make such a legal commitment; and abundant evidence that Alcan has in the past and would continue in the future to refuse to make such a legal commitment.

²⁴ BCOAPO, p.16.

25. Third, BCOAPO does not satisfactorily reconcile its various statements regarding whether the 2007 EPA is ‘cost effective’ within the meaning of s.71(2)(a) to (d) with its position that the 2007 EPA *with a smelter condition* should be approved under s.71(2)(a) to (e).
26. BCOAPO’s position on s.71(2)(a) to (d) cost-effectiveness of the 2007 EPA (without smelter conditions) is mixed. BCOAPO says “We also generally accept the analysis presented in Chapter 7 of Exhibit B1-2-1 and we note that it follows the methodology presented and tested in previous proceedings such as the 2006 IEP/LTAP.”²⁵ However, BCOAPO also states that “We believe that BC Hydro left some money on the table when viewed from Alcan’s opportunity cost perspective.”²⁶
27. BCOAPO then ties its s.71(2)(a) to (d) position to its s.71(2)(e) position by stating, “Despite our concerns about BC Hydro’s valuation of certain aspects of this EPA, BCOAPO believes that the amount of money BC Hydro left on the table is not reason enough to reject it provided concerns about regional socioeconomic impacts are adequately addressed in the end result.”²⁷
28. As discussed above, BCOAPO’s proposal for adequately addressing “concerns about regional socioeconomic impacts” of the 2007 EPA is that the BCUC accept the 2007 EPA on a condition (expiry upon non-completion of the Modernization Project) that allows Alcan to walk away from the 2007 EPA. Indeed, on the available evidence it would be realistic to assume for the purpose of analysis that there is fairly high likelihood that such a condition would be fatal to the 2007 EPA.
29. Thus, BCOAPO is equivocal on the cost effectiveness of the 2007 EPA under s.71(2)(a) to (d), but says that upon consideration of the s.71(2)(e) factors it would be in the public interest, overall, to approve the 2007 EPA but with a likely-to-be-fatal smelter condition.

²⁵ BCOAPO, p.7.

²⁶ BCOAPO, p.13.

²⁷ BCOAPO, p.14.

30. While BCOAPO may not have intended it this way, the position boils down to the concept that the ratepayers have little to lose in terms of rate impact if the addition of the smelter condition kills the 2007 EPA because the 2007 EPA is probably not cost effective anyway. With respect, that would not be a satisfactory analysis under s.71(2).

31. Fourth, BCOAPO's analysis of the *cost-effectiveness* of the 2007 EPA in the scenario in which the Modernization Project does *not* proceed is, BCSEA, *et al* respectfully suggest, backwards. BCOAPO states:²⁸

While the Agreement contains provisions addressing the scenario which would emerge if the modernization were not to proceed, we submit that this scenario would leave BC Hydro with a fundamentally different scale and type of supply resource and would significantly magnify the longer-term risk to ratepayers saddled with costs that are greater than could have been negotiated had BC Hydro sought a price for energy which is closer to Alcan's opportunity cost. [underline added]

32. In reality, if the 2007 EPA is approved and the Modernization Project does not proceed (and presumably the Smelter Load is less than 697 avMW) then, from a strictly cost-effectiveness perspective, BC Hydro reaps a windfall. There is additional firm Kemano power sold to BC Hydro at a Tier 2 price (or Alcan staunches its losses by paying the carve-out penalty). Directionally, the cost-effectiveness of the 2007 EPA *improves*, rather than declines, if the Modernization Project does not proceed.

33. Further, BCOAPO's phrase "the longer-term risk to ratepayers saddled with costs that are greater than could have been negotiated had BC Hydro sought a price for energy which is closer to Alcan's opportunity cost" is inaccurate. There is no evidence that the prices in the 2007 EPA are "greater than could have been negotiated had BC Hydro sought" some lower price. The prices in the 2007 EPA are the outcome of confidential bilateral negotiations between arms' length professionally-advised corporations. There is, of course, no evidence as to what prices BC Hydro "sought"

²⁸ BCOAPO, p.7.

and certainly no evidence that the negotiated prices could have been lower if BC Hydro had bargained differently.

CAW Local 2301

34. In its final argument, CAW Local 2301 (“CAW” or “Union”) provides a detailed analysis of the evidence in relation to the Union’s objectives and concerns. In the end, the CAW takes the position that “the 2007 EPA as written is not in the public’s interest and should be rejected by the BCUC.”²⁹ The CAW takes the position that “for the 2007 EPA to be acceptable it must contain a project agreement” that “guarantees that the modernization at Kitimat Works goes ahead and is completed by 2012 as planned,” “ensures that the Pre-bake pots are started up and ramped up to full production,” and includes “benchmarks to ensure this new plant will continue to run for the 35 – 50 years Alcan keeps talking about.”³⁰ The CAW also states that the Commission should make a “Project Agreement” a condition to be part of the 2007 EPA.
35. BCSEA, *et al*’s response begins with the crucial legal point that the BCUC cannot impose on Alcan and BC Hydro a Project Agreement or even a specific condition such as completion of the Modernization Project that is not agreed to by both Alcan and BC Hydro. If the Commission did determine that the 2007 EPA would be approved but only if conditions regarding the smelter were added, then it would be Alcan’s legal right to refuse to accept the conditions, causing the 2007 EPA to be cancelled.
36. By saying that the 2007 EPA is not acceptable without terms and conditions regarding the Modernization Project, etc., the CAW is effectively giving Alcan the opportunity to back out of the 2007 EPA if Alcan so chooses.

²⁹ CAW Final Argument, p.13.

³⁰ CAW, pp.13-14.

37. The CAW states in no uncertain terms that “The Union wants this modernization project to be completed.”³¹ BCSEA, *et al* have the same objective.
38. BCSEA, *et al* have asked the Commission to conclude that completion of the Modernization Project would be in the public interest; and to conclude that approval of the 2007 EPA would make completion of the Modernization Project modestly more likely rather than less likely. Approval of the 2007 EPA means approval without conditions that would allow Alcan to walk away from the 2007 EPA.
39. BCSEA, *et al* respectfully disagree with the CAW’s approach of promoting completion of the Modernization Project by calling for the Commission to add smelter conditions to the 2007 EPA. If the Commission concludes that completion of the Modernization Project would be in the public interest, then BCSEA, *et al* say that the Commission should *not* add smelter conditions to the 2007 EPA. Adding smelter conditions to the 2007 EPA would allow Alcan to back out of the 2007 EPA and to have an excuse (if it should want one) to fail to complete the Modernization Project.

ALL THE ABOVE IS RESPECTFULLY SUBMITTED



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³¹ CAW, p.12.