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Re: Comments of Alcoa on IOUs' and Preference Utilities' Proposal.

Alcoa Inc. submits the following: (1) comments on the September 16, 2002 proposal of the IOUs and the preference utilities ("Utility Proposal"), and (2) supplemental comments on the September 12, 2002 proposal of Alcoa Inc. ("Alcoa Proposal").

I. Comments on the Utility Proposal

A. <u>The total allocation for smelter load is too small.</u> The Proposal provides a total potential allocation of only 600 MW for the entire Northwest Aluminum industry. This amount is arbitrary, and the Proposal does not provide any explanation for this amount. The amount is not related either to the total potential smelter load of approximately 3000 MW or the current subscription amount of approximately 1400 MW. The rationale for offering Alcoa a new contract for up to 700 MW is contained in section II of these comments.

B. <u>The Base per-smelter allocation of 100 MW is arbitrary</u>. The Proposal provides a base per smelter allocation of 100 MW. Again, the Proposal provides no explanation for this amount. In fact, the base allocation of 100 MW/smelter is arbitrary; it is not related to smelter size, current subscription amounts, etc. The IOU/publics state that (in disallowing aggregation of allocations except on a temporary basis) that "each allocation of federal power is intended to support continued operation of a specific smelter." Utility Proposal at 19. If so, then smelter specifics should be considered in the base allocation, especially size.

The IOUs/publics propose certain factors that BPA should apply to exclude some smelters from "qualifying" for the base allocation. For anti-trust reasons, Alcoa cannot agree with the IOUs/publics on arbitrary terms that would exclude other smelters from an allocation.

C. <u>Allocations above 100 MW/smelter should be allowed</u>. The IOU/publics provide that "to the extent that BPA acquires the output [of an incremental generating resource] so offered", a DSI can receive an allocation above the 100 MW base amount. Without the arbitrary MW limits proposed by the IOUs/publics, this is similar to Alcoa's proposal: a DSI that offers BPA a resource at cost should be allowed to purchase an equivalent amount of federal power at the §7(c) rate. As discussed in Alcoa's proposal, that would allow BPA to serve Alcoa's load without putting BPA into short-term power markets to acquire energy for this service and, thus, would eliminate one of the factors that caused the current high BPA rates.

D. Alcoa supports credit assurance. The IOUs/publics propose that DSI contracts should include a provision for credit assurance, load loss, and contract termination. Alcoa agrees that all BPA power sales contracts should include performance assurance or other provisions that assure BPA's other customers that a default by such customers will not impose costs on BPA's remaining customers. This is standard in the marketplace, and defaults on current contracts have increased the current FB-CRAC rate surcharge to Alcoa and other customers.

Alcoa's proposal achieves this goal for BPA power sales contracts with DSIs, i.e. BPA's obligation to acquire power to serve Alcoa would be terminated if Alcoa failed to perform on its power purchase agreement with BPA. Thus, there would be no costs that BPA must recover from other customers.

E. A sleeve, if available, should be available to credit-worthy customers. The IOU/publics support a sleeve to DSIs that are "willing to contractually dedicate [the resource output] to serving their in-region smelter load not served by BPA, and who are unable to otherwise procure financing for such resources". Utility Proposal at 19.

Because Alcoa's credit is good, this provision would not be available to Alcoa. If a sleeve is appropriate, it should be available to all customers. The credit of the customer should be a factor BPA should consider in whether a particular sleeve is prudent, i.e. the ability of a customer to pay BPA for the sleeved power.

F. BPA should not preclude further contracts with Alcoa. The IOU/publics propose a contract provision that would preclude any further power sale by BPA to a DSI that "does not fully recover all the costs of providing such a service." A 7(c) sale, with melded augmentation costs, does fully recover all costs of this service. To this extent, the IOU/public proposal is harmless. However, if the IOU/publics mean that any further sale to a DSI must be a SP market rate sale and not a sale at the IP rate, then this provision unreasonably limits BPA's statutory authority to make such sales in the future, and could result in unfair and harmful discrimination against certain BPA customers.

G. The IOU financial benefits are arbitrary and not tied to any statutory basis. The IOU financial benefits are characterized as a settlement of residential exchange rights. However, there is no linkage between the amount of the financial benefits and the statutory basis for determining these benefits. For example, the exchange benefits are based on the difference between IOU resource costs and BPA resource costs, but the proposed financial benefits do not rely in any way on actual IOU resource costs. Similarly, as discussed in the Alcoa/Golden Northwest comments dated September 11, 2002, the proposed IOU financial benefits ignore §7(b)2. This is perhaps best seen in the Proposal's treatment of the PGE sale:

> In the event that the section 7(b)(2) rate test triggers and a surcharge is imposed on this sale, PGE will have the contractual right to terminate the sale and take full financial benefits in lieu of the power sale.

Finally, the IOU benefits are <u>never</u> negative: In the event the Net Slice Costs exceed the cost of power from the CCCT as determined by the above calculations ("C" is greater than "A" + "B"), the financial benefits to the investor owned utilities will be zero until such time as the CCCT costs exceed the Net Slice Costs. In other words, there will be no accrual or payment of any negative benefits. Thus, the IOU/publics proposal does <u>not</u> align risks and benefits. If BPA's costs increase dramatically, rates could exceed market (or exceed IOU resource costs) but the IOUs would still receive payments or <u>at worse</u> would receive nothing. In effect, IOUs are allowed to swing on-and-off BPA; to take money when BPA is low cost but not to contribute when BPA is high costs.

II. Supplemental Comments to the Alcoa Proposal

Several people have raised questions about the intent of the Alcoa proposal after it was submitted on September 12. The following comments are intended to answer those questions.

A. <u>The Alcoa resource offer may apply to BPA preferred resources.</u> Under the Alcoa Proposal, we offered to sell to BPA power from sources not currently committed to the region. BPA would not be responsible for paying for the Alcoa resource if Alcoa did not meet its obligations under the new BPA power purchase agreement. In this way, Alcoa would shield BPA and its other customers from the risks of the aluminum business. We stated that the resource offered would meet a reasonable standard to qualify, but that if BPA preferred a different resource, it should acquire the preferred resource, but still serve Alcoa.

Some people have asked if Alcoa would be willing to relieve BPA of the ultimate responsibility for paying for its preferred resource in lieu of the Alcoa resource.

Because Alcoa may be ultimately responsible for the resource acquired, we cannot make a blanket statement that we are willing to back any, as yet unnamed, resources, but we can say that we would be willing to work with BPA and back resources that meet the mutual needs of Alcoa and BPA. We expect that we could reach agreement because we believe our goals are the same for clean, efficient, and economical power resources.

B. <u>Alcoa is willing to share the benefits of the Alcoa resource with BPA.</u> Under the Alcoa Proposal, to the extent that Alcoa does not purchase or pay for power under the BPA power sales agreement; BPA would not be obligated to pay for the Alcoa resource.

Some people have speculated that if power market prices were very high, and aluminum prices are very low, Alcoa might curtail its Northwest aluminum smelters, and sell power from the Alcoa resource. If that should happen, those people have asked if Alcoa is willing to share some of the potential profit from sale of power from the Alcoa resource.

Alcoa recognizes that under the Alcoa Proposal, it is both Alcoa's willingness to back a resource, and BPA's willingness to purchase the resource that makes the resource possible. Also, if Alcoa curtails Northwest aluminum production, to make a sale possible, its employees, communities and stockholders will be impacted. We believe that if the circumstances above come to pass, it would be appropriate to share the benefits of any excess revenue from power sales with all stakeholders, including BPA. Without knowing the exact circumstances, however, we do not propose to know the fair allocation of those benefits.

C. Employment depends on adequate amounts of BPA power at economical rates. Under the Alcoa Proposal, BPA would offer up to 700 MW power to Alcoa to meet our electrical requirements beyond existing commitments from other suppliers. BPA would set its rate to Alcoa based on the rate directives in the Northwest Power Act.

Some people have asked why Alcoa is asking for so much power from BPA.

For a variety of reasons, BPA rates have increased dramatically in recent years. Under the rate directives of the Northwest Power Act, rates to Alcoa have increased along with other customer rates. We believe that it is absolutely necessary for BPA to take strong measures to control its costs, and that those cost control measures should result in lower power rates for all customers, including Alcoa. We recognize that circumstances outside of BPA's control have resulted in higher rates, and it is unlikely that they will revert to historically low levels. At the same time, even though BPA rates have increased, they are still below the cost of new generating resources.

We believe that with access to enough BPA power to allow our aluminum smelters to operate at economically efficient levels, and adequate BPA cost control, we will be able to continue to produce aluminum in the Northwest that can compete with producers around the world. If we do not get enough BPA power, we would be forced to operate at lower, inefficient operating levels, or purchase supplemental power from others at high incremental prices. Either event would increase our cost of producing a pound of aluminum, and threaten our ability to continue our operations.

Expected BPA rates are so close to the maximum that we can afford, that we cannot in good faith lead people to believe that lower allocations will have the intended result of saving Northwest aluminum jobs.