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Frank L. Cassidy  
Chairman  
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851 SW 6<sup>th</sup> Ave., Ste 1100  
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Re: Proposal for Post-2006 BPA Role Dialog

Dear Mr. Wright and Mr. Cassidy:

Attached please find an Alcoa Inc. proposal for the future role of BPA in response to your letter of June 10, 2002.

We have also submitted comments of a more general nature jointly with Golden Northwest Aluminum, Inc.

Alcoa believes that BPA should meet all of its responsibilities in the 1980 Northwest Power Act, and that fairness requires BPA to offer Alcoa adequate amounts of power for its plants at rates that are equitable when compared to other industries in the Northwest. We recognize that our electrical loads are larger than most other industries, and are willing to accept responsibilities that are not required of others. Alcoa is offering to back-up new power resources to insure that BPA and its other ratepayers will not be saddled with costs for unneeded power caused by changes in the aluminum market.

The Alcoa proposal is fair, helps the local and regional economy, and is good policy for the United States.

Sincerely,

Jack A. Speer  
Northwest Energy Director

**Future BPA Role**  
**Proposed by**  
**Alcoa Inc.**

**September 12, 2002**

The Issue

The Northwest Power Planning Council and the Bonneville Power Administration are attempting to decide how BPA will market the power and distribute the costs and benefits of the Federal Columbia River Power System (FCRPS) in the Pacific Northwest after 2006.

This is a fundamental decision that will impact the lives of millions of people in the Northwest, and it is difficult because it ultimately will be based on values held by those who provide input, and by the decision makers. It involves not only what is legal, but also what is equitable.

The most important issue to Alcoa is whether Alcoa will continue to receive power from BPA at rates that reflect the cost of generation from vintage power plants. How that issue is decided will likely determine whether or not our manufacturing plants can economically survive in the Northwest.

Some people will argue that because the Northwest Power Planning and Conservation Act of 1980 does not explicitly require BPA to serve Direct Service Industrial customers after 2006, that BPA should not provide power to these customers, and should throw all of them out of the life boat so that others can have lower power rates.

Alcoa believes that it is only by historical quirk that the electrical needs of its plants were served directly by BPA rather than as customers of local utilities, and that it would not be fair to our company, or employees or the communities that depend on our operations to treat us fundamentally different than other long-term industrial electricity consumers in the Northwest. We believe that we and other industrial firms should continue to have access to electricity based on the cost of production from power plants that were built to serve regional loads years ago, just like other consumers in the region. Our power bills helped to build and pay for these power plants, and it would not be fair to now direct the benefits to others, and force us sink or swim based on the cost of newly constructed

generation plants while other industries in the region continue to purchase vintage priced power.

There is no doubt that BPA has the legal authority to continue to serve our electrical loads at rates that reflect costs from vintage power plants, the only question is whether their values tell them it is the right thing to do.

### Broad Overview of the BPA Decision

In the "Fact Sheet on the Regional Dialogue" attached to the June 19, 2002 letter from BPA and the Council, there were 5 principles established by BPA to judge proposals. Alcoa supports those principles, and believes BPA should move quickly to design and implement a plan that is consistent with those principles. Principle number 4 addresses a fundamental decision that BPA has already made. It states that approaches or policy options should not require legislative changes and should minimize legal risks.

Staying within existing law and minimizing legal risks is an important matter. BPA has rightly decided to reject solutions that are not clearly within BPA's existing statutory authority. If BPA were to stretch its legal limits, its actions would be subject to significant legal challenges that would cause uncertainty to persist until the matter is resolved through the courts. Such uncertainty, even if the courts were to eventually uphold BPA's authority to take such actions, would negatively impact long term planning of consumers and power suppliers in the region.

Alcoa believes that BPA simply needs to affirm that there is consensus in the region that no legislative changes are necessary, and then design a fair plan that is clearly within its authority under the Northwest Power Act. After a concentrated period of public comment on the BPA plan, BPA should issue a Record of Decision, and immediately negotiate and sign bilateral contracts under its existing authority with its customers. This process will resolve issues as quickly as possible, and allow for planning certainty for those who need to make capital investment decisions regarding generation plants and other facilities in the Northwest.

### Current BPA Role

Under current law BPA has certain responsibilities. While some parties may not like the effect of the law under current conditions, those provisions do constitute BPA's role, and since BPA has decided not to seek legislative change, they do determine the framework for BPA future actions.

Under existing law, BPA must:

1. Encourage conservation and renewable resources.
2. Protect, mitigate and enhance fish and wildlife resources.
3. Observe regional preference.
4. Offer to serve the net requirements of preference utilities and the load growth of investor-owned utilities.
5. Offer to exchange power with utilities for the benefit of residential consumers.
6. Assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply.
7. Meet the rate directives of the Northwest Power Act including:
  - a. A cost-based rate to meet the general requirements of public body, cooperative, and Federal agency customers. That cost-based rate must not exceed the "rate test" included in Section 7(b)(2) of the Northwest Power Act.
  - b. A rate for Direct Service Industrial Customers which is equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.
  - c. A rate for New Large Single Loads.

Under existing law, BPA is authorized to:

1. Sell power to Federal agencies in the Region.
2. Sell power to existing Direct Service Industries.
3. Acquire resources to meet its obligations.
4. Restrict deliveries of power if it cannot acquire sufficient resources.

### The Northwest Power Act in Context

The Pacific Northwest Electric Power Planning and Conservation Act was developed during a period of time when it was anticipated that federal hydroelectric projects would not be adequate to meet the growing requirements of preference utilities and as well as supply traditional customers such as investor-owned utilities and Direct Service Industries. Instead of creating a regional battle over the allocation of limited resources, the Northwest Power Act authorized BPA to purchase additional power resources to meet limited needs of its traditional customers under equitable rate directives. It was expected that new, capital intensive power plants with long lead times would be acquired by BPA, and that would minimize total power costs in the region.

Preference utilities were entitled to BPA power in amounts necessary to meet their growing needs at rates that would not be higher than if BPA had simply allocated federal resources, investor-owned utilities were entitled to exchange power with BPA for the benefit of their residential consumers so that power costs for these loads would be no higher than power costs for similar customers served

by preference utilities. Direct Service Industrial customers were allowed to purchase traditional amounts from BPA at rates that funded the investor-owned utility exchange for the first 5 years following the passage of the Act, and were set to be equitable with other industries served by preference utilities after that point.

Provisions were included in the Northwest Power act so that environmental, fish and wildlife, tribal and consumer interests were also protected.

In summary, the Northwest Power Act provided a balance between many interests that could only be accomplished legislatively. BPA should not, and cannot materially change that balance without legislative authorization.

### General BPA Role Proposal

Following is a general outline of how BPA should proceed to meet its obligations under existing law:

BPA should:

1. Estimate loads that are likely to be requested by its traditional customers after consulting with those customers. These customers include existing and new preference utilities, investor-owned utilities, direct service industries, and federal agencies.
2. Offer to exchange power with the IOU's as provided under law and end the practice of offering power in settlement of future exchange benefit disputes.
3. Estimate new resource amounts and costs necessary to meet anticipated customer requests.
4. Acquire cost effective conservation and renewable resources.
5. Meet all of its non-power obligations.
6. Estimate its power rates as prescribed under the rate directives of the Northwest Power Act.
7. Sign bilateral contracts with its traditional customers, acquire necessary power resources and set rates in a tight time frame in order to minimize BPA risks of being power surplus or deficit.

Contracts can be of various lengths to accommodate the economics of resource acquisition, and uncertainty of customer requirements, but should be designed to cover BPA costs should customer requirements change during a contract term. Customers who sign up to purchase BPA power should have a good idea of what the costs will be, and should be responsible for covering

those costs to avoid increased risk of BPA revenue shortfall and risks to other customers, and to the US Treasury.

The items above are iterative in nature and cannot be done strictly in sequence. BPA should establish long-standing principles on rate making to provide the stability necessary for customers to make long-range plans, but actual rates need to be set at least every 5 years in order to meet statutory rate requirements.

### Specific Process Proposal

1. While the current proposal and comment period is proceeding, BPA should begin immediately to discuss with each of its customers how much load each customer would place on BPA given rough estimates of rates and contract design consistent with existing law after October 1, 2006 and equity described in the general proposal above.
2. After getting inputs from customers, BPA should attempt to refine the rate estimate that would result from the customer requests, communicate that to its customers, and refine load estimates.
3. About the time the joint BPA/Council process has been completed on October 18, BPA should have a rough idea of the resources needed and the results of allowing customers to request loads as contemplated under the Northwest Power Act.
4. With the input provided from the BPA/Council process and the information from BPA's interaction with the customers, BPA should have the tools necessary to proceed with a detailed proposal.
5. BPA should conduct a brief public process on its proposal and issue a Record of Decision before December 31, 2002.
6. Rate making principles (not rate setting) can then be adopted by April 1, 2003.
7. Bilateral contracts that are consistent with the BPA Record of Decision can then be negotiated with individual customers on a time frame that meets the individual customer needs.

### Specific Alcoa Contract Proposal

Alcoa has owned and operated primary aluminum plants in the Northwest since 1940 and has purchased BPA power continuously during the entire time. We believe we should be treated no worse in new contracts than if we had been a customer of our local utilities during that period of time rather than a Direct Service Industrial customer of BPA. We believe that BPA should offer to sell power to Alcoa at rates that are equivalent to rates paid by industrial customers of BPA preference utilities in amounts up to the amounts not covered by existing contracts.

Consistent with that standard, we would like to receive an offer from BPA to purchase up to a total amount of 700 MW of power to meet our incremental needs at our Intalco and Wenatchee plants for a period of not less than 10 years from the expiration of our current contract. To keep a workable planning horizon, we believe the contract should be extended in 5-year increments well before its expiration date. Since our goal is to operate our aluminum plants with the associated employment and economic benefits to our communities and to the region, the rate and contract terms will determine our economics. Our ability to commit to a contract, and the amount and duration of the contract may change depending upon the outcome of bilateral negotiations with BPA.

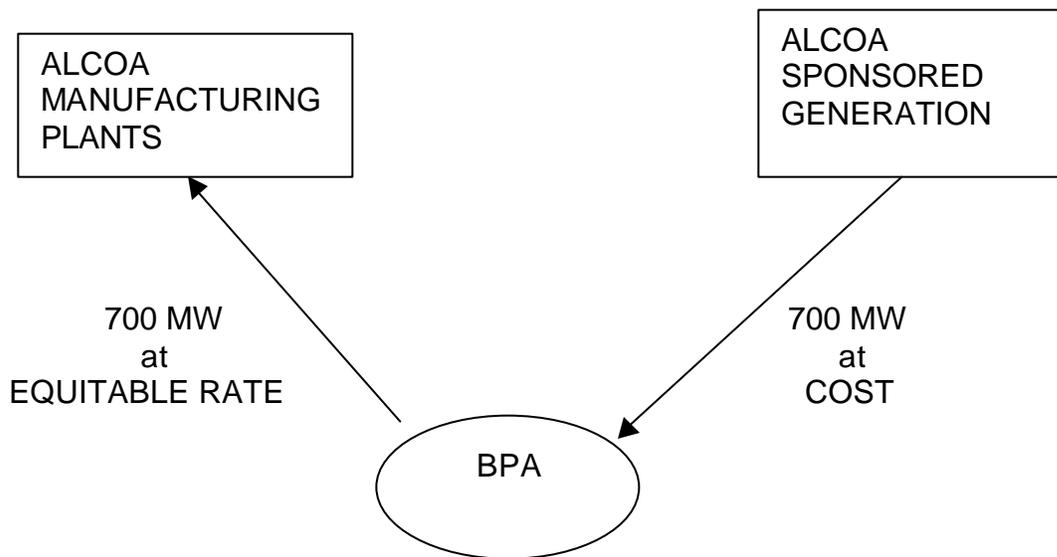
While Alcoa believes it should be treated equitably with other industries in the Northwest, we also appreciate the cooperative relationship between BPA and Alcoa that has allowed us to operate in the region for about 60 years with many benefits to many parties. While we recognize that the sum of all transactions must allow us to economically operate, Alcoa believes that new contracts should be designed so BPA and other BPA customers are not disadvantaged if DSI customers do not meet their contractual obligations. .

Under the Alcoa plan, Alcoa would purchase our electrical requirements beyond existing commitments from other suppliers (up to 700 MW) from BPA at the equitable rate, and offer to sell to BPA the same amount of power from sources not currently committed to the region. The new resource could be in the form of a contract from existing resources, from plants that are currently under construction, or from new power plants. Alcoa would continue to provide transmission stability reserves provided in BPA-TBL's tariff and service agreements. BPA would be responsible for the costs of the new resources (including a reasonable return on invested capital) as long as Alcoa met its obligations under the new power sales contract. To the extent Alcoa does not purchase or pay for power under the new power sales contract for any reason, including bankruptcy, BPA would not be obligated to purchase and pay for the new power resource, and BPA and its other customers would not be adversely impacted by Alcoa's action.

The resource offered by Alcoa would have to meet a reasonable standard to qualify as an acceptable resource, and BPA would not be obligated to serve Alcoa if the resource did not meet that standard. If Alcoa offers a resource that meets the standard, but BPA prefers another resource, BPA should acquire the preferred source, but should still serve Alcoa.

The following diagram shows the concept for the Alcoa plan assuming the maximum amount of the Alcoa purchase.

## The Alcoa Plan



### Questions and Answers on the Impacts of the Alcoa Plan

Q1 - How does the Alcoa Plan meet the first of the 5 BPA crucial principles?

A1 - The first principle is to preserve or enhance all the long-term and diverse benefits of the FCRPS for the region. The Alcoa Plan would lead to BPA contracts and policies that were well within BPA's legal authorities and have stood the test of time and legal challenges. Benefits would be distributed as envisioned by the Northwest Power Act equitably within the region, and the risk of legislative or judicial actions that would overturn the BPA actions would be minimized. The offer to bring new power resources to cover our BPA contract, and to relieve BPA of the obligation for those resources in the event of an Alcoa default provides a mechanism for reducing risk for other customers.

Q2 - How does the Alcoa Plan meet the second of the 5 BPA crucial principles?

A2 - The second principle is that policy outcomes must be enduring under a range of political and economic conditions. As mentioned above, the Alcoa Plan

is stable and enduring because it stays well within existing statutes and minimizes legislative and judicial challenges. Beyond that, it allows BPA to work within existing mechanisms to provide political equity as times change. It would allow aluminum companies and their communities fair access to vintage priced power so they can have a opportunity to remain economically healthy, and yet would not expose BPA and its other customers to the financial risk of power purchase commitments which became surplus if the companies are not able to maintain the viability of their operations.

Q3 - How does the Alcoa Plan meet the third of the 5 BPA crucial principles?

A3 - The third principle is that there should be no additional risks for the U.S. taxpayers and the Federal Treasury. The Alcoa Plan, since it does not change the law, or BPA's ratemaking ability would allow BPA to establish the same Treasury Payment Probability (TPP) as is currently the case. The same TPP would probably occur at a lower rate level, however, since BPA would not be concerned about additional obligations if a DSI fails to perform under the new contract.

Q4 - How does the Alcoa Plan meet the fourth of the 5 BPA crucial principles?

A4 - The fourth principle is that approaches or policy options should not require legislative changes and should minimize legal risks. The Alcoa plan calls for no legislative change and minimizes risks by staying well within the mechanisms allowed under current law. This is the heart of the Alcoa Plan, and will help to lead to stable and predictable power supplies and rates in the Northwest.

Q5 - How does the Alcoa Plan meet the fifth of the 5 BPA crucial principles?

A5 - The fifth principle is that there should be clarity regarding BPA's load obligations after 2006. Under the Alcoa Plan, BPA would consult with customers and sign contracts at the same time as it acquired resources and set rates. By the time BPA and the customers signed contracts, BPA and its customers would know what the responsibilities were to acquire resources, and to pay for those resources through BPA rates. Obligations would be clear, and decisions would be made in a timeframe that would meet the needs of customers and power suppliers. Moreover, the Alcoa plan automatically adjusts, without financial penalty to BPA, BPA's service obligation to a DSI and its power purchase commitments.

Q6 - Should DSIs receive cost-based power from BPA after 2006? If so, how much?

A6 - BPA should offer to serve the entire eligible load of DSI customers at the "equitable" rate established under the Northwest Power Act. BPA should not be picking losers and winners in a federal power allocation scheme, but should offer

power to all existing customers who are allowed under the Northwest Power Act. Contracts for this power should protect BPA and other BPA customers from the impacts of a default by the DSI customer. Under the Alcoa Plan, this protection is provided by the resource that is offered to BPA to cover the DSI load, and the fact that there would be no obligation for BPA to pay for that resource if the DSI defaults. Because the contracting/resource acquiring process is iterative, it is difficult to determine how much DSI load will actually commit to new contracts, but this process will provide a fair amount of power to DSI companies who are willing to accept the obligations of new contracts and protect other BPA customers from inappropriate business risks.

Q7 - Should the residential and small farm customers of regional IOUs receive Federal power, or only financial benefits, to satisfy the residential exchange provisions of the Northwest Power Act? If so, at what levels?

A7 - Existing contracts should be honored, but all future contracts should be in the form of financial benefits as contemplated by the terms of the Northwest Power Act. This will reduce future risk and uncertainty. BPA should assure that its policies and methodologies for exchange benefits are adequate to provide a level of benefit that assures the residential and small farm customers of regional IOUs have essentially the same wholesale power cost as their counterparts served by Consumer Owned Utilities to the extent that is possible after complying with the Section 7(b)(2) rate test of the Northwest Power Act.

Q8 - What provisions should be made for service to newly formed public utilities?

A8 - In the long term, BPA should treat newly formed public utilities the same as existing public utilities, however there should be time limits established in order to keep rates stable for existing customers within a rate period. New customers should have to wait until the beginning of the next rate period for service at a melded-cost rate if immediate service would significantly impact current rates for existing customers.

Q9 - Should steps be taken to minimize the additional loads that BPA would have to serve in order to limit the amount of resources that BPA would need to acquire?

A9 - Customers should be able to request BPA power in amounts allowed under the Northwest Power Act after taking into effect the rate impacts necessary for BPA to meet those loads. New customers should have to wait until the next rate period for service at a melded-cost rate to avoid significant current rate impacts on existing customers. Within the customer groups that BPA is authorized to serve, BPA should not pick and chose which are to receive new contracts. If a customer accepts the obligations in the new contract necessary to protect BPA and its other customers, that customer should be offered a contract.

Q10 - If BPA does need to acquire new resources, should BPA do so by buying power in the market or by purchasing it directly from developers of new resources?

A10 - BPA should work with the Northwest Power Planning Council and its Customers to assure the Pacific Northwest of an adequate, efficient, economical and reliable power supply. We should not limit BPA's ability to carry out this mandate by placing limits on BPA's actions beyond what is specified in the law. Under the Alcoa Plan, we propose that BPA buy power from resources that we offer that meet a certain standard in order to reduce risks to other customers. However, if BPA believes they can obtain a power resource that is better than the one offered by Alcoa, they should do so.

Q11 - Should power from the existing Federal system be sold among BPA's regional customers, with customers themselves meeting their additional power needs? If so, how should the power be sold?

A11 - BPA should offer to sell power to its regional customers as allowed under the Northwest Power Act. The Act contemplated a certain sharing of costs of new resources and melding by BPA in rates that it would offer to its customers. The Act also contemplated a "net requirements" product where utilities would chose to meet part of their own load requirements, but the portion they purchased from BPA would still be a melded rate for all Federal system resources, including new purchases and acquisitions designated as replacement FBS resources.

Q12 - If BPA does acquire resources, as it has for the current five-year rate period, how should its power be priced? Should BPA continue to meld all the costs of its power together into one rate? Or, should BPA adopt a "tiered rate" system whereby power produced by the existing federal system would continue to be sold at its cost while additional power purchased in the market or directly from developers would be sold at those market or project-based prices?

A12 - BPA should price power in accordance with the rate directives of the Northwest Power Act. This means that BPA should continue to meld costs as required in the Act. Tiered rates may have been useful as a short-term rate tool when allocations have already been made such as occurred in 2001, but they were rejected at the time of the Northwest Power Act as an inappropriate way of solving long-term Northwest power problems, and should not be adopted as a long-term policy without clear legislative authority.

Q13 - What kinds of power products should BPA offer its customers?

A13 - BPA should offer requirements, partial requirements, and block products as a foundation, but should have the flexibility to offer other products that are

consistent with BPA's legal authorities, as long as other customers are not adversely impacted.

Q14 - What flexibility should utilities have regarding the use of the Federal power that they purchase from BPA?

A14 - BPA power should be used to serve eligible loads in the Northwest. Beyond that, utilities and DSI's should have the flexibility to manage their own loads and resources to meet their own needs.