Global Power/North America
New Issue

Energy Northwest

Bonneville Power Administration

Ratings

New Issue

$620 Million Series 2004A, 2004B (taxable) and 2004C Project No. 1, Columbia Generating Station and Project No. 3 Refunding Electric Revenue Bonds ....AA–

Outstanding Debt

Security Class	Current Rating	Previous Rating	Date Changed
$6 Billion Revenue Bonds	AA–	AA	3/11/03

Rating Watch..None
Rating Outlook.. Stable

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Profile

Energy Northwest (formerly the Washington Public Power Supply System) owns and operates the Columbia Generating Station, previously known as Nuclear Project No. 2. BPA purchases the project power under agreement and markets the power along with electricity from 30 federally owned hydroelectric projects across its high-voltage transmission network throughout the Pacific Northwest. BPA is the largest of the regional federal power marketing agencies.

Key Credit Strengths (BPA)

- Largest provider of electricity and transmission in the Pacific Northwest.
- Energy Northwest debt paid prior to U.S. Treasury payments.
- Improved rate-setting flexibility.
- Reasonably priced power.

Key Credit Concerns

- Inconsistent financial performance.
- Volatility associated with hydro-based system.
- History of increasing rates.
- Political and litigation uncertainty.

May 17, 2004

Rating Rationale

Fitch Ratings has assigned a ‘AA–’ rating to the new series 2004 bonds and affirmed the ‘AA–’ rating on Energy Northwest’s approximately $6 billion outstanding electric revenue bonds. The Rating Outlook is Stable.

Factors that support the rating include Bonneville Power Administration’s (BPA) obligation to pay debt service on the Energy Northwest bonds prior to any U.S. Treasury payments, the importance of the federal power marketing agency in supplying electricity and transmission service in the Pacific Northwest and a more flexible rate-adjustment strategy. The implementation of the three-step, cost-recovery adjustment clause (CRAC) adds improved rate flexibility and is intended to reduce BPA’s need to maintain larger reserve positions. Wholesale rates are forecasted to remain competitive for the region. Also, as a federal power marketing agency, BPA enjoys certain beneficial standing in the financing of its projects and access to lower cost capital.

Regarding credit concerns, lower than normal water conditions, some softness of the regional economy, power price fluctuations and an aggressive power procurement strategy have adversely affected BPA’s past fiscal performance. While electric rates are still competitive, they now stand well-above historical standards. In the future, greater clarity about BPA’s longer term power supply responsibility for the region, a more conservative approach to power supply planning and a more predictable financial performance would benefit BPA and potentially result in a better rating for the Energy Northwest bonds.

Security and New Issue Details

Energy Northwest plans to issue approximately $620 million of series 2004 refunding electric revenue bonds (taxable and tax-exempt) to refund outstanding bonds related to Project No. 1, the Columbia Generating Station (formerly Nuclear Project No. 2) and Project No. 3 and finance the costs of certain capital improvements at the Columbia Generating Station. The 2004 bonds are secured on a subordinated basis to the prior-lien bonds from amounts derived pursuant to net billing agreements with the U.S. Department of Energy (DOE), acting by and through the administrator of the BPA from net billing credits and cash payments from the Bonneville Fund. The prior-lien resolution was previously closed. BPA’s obligation to make payments continues notwithstanding suspension or termination of any of the projects. While BPA’s commitment under the net billing agreements are not general obligations of the United States and are not secured by the full faith and credit of the federal government, it does come before any payments or repayments of funds to the U.S. Treasury. There is no reserve account securing repayment of the 2004 bonds. Goldman Sachs Group, Inc. will act as lead manager for the bonds, and pricing is scheduled for May 19, 2004.

Energy Northwest

Energy Northwest is empowered by the state of Washington to finance, acquire, construct and operate facilities for the generation and transmission of electric power. It currently has 17 members, consisting of 14 public utility districts and the cities of Richland, Seattle and Tacoma, Wash. Energy Northwest owns and operates a nuclear generating station, Columbia Generating Station, with a net design rating of 1,153 megawatts (mw), the Packwood Lake Hydroelectric Project and the Nine Canyon Wind Project. The Columbia Generating Station is licensed to operate into 2023. In fiscal-year 2002, the capacity factor set a record for the plant at 92%. In fiscal-year 2003, the plant capacity factor was 78.5%, which reflected three forced outages along with a scheduled refueling, which occurs every two years. Columbia Generating Station's electricity is projected at $21.85 per megawatt-hour (mwh) during fiscal-year 2004 compared with $30.10 per mwh in 2003, which was above earlier estimates. To increase the value of the plant over time, engineers are working on a proposal to extend Columbia Generating Station's 40-year operating license by 20 years, from 2023–2043. The current decommissioning plan assumes annual deposits through fiscal-year 2024 and that Columbia Generating Station will be placed in an approximately 60-year safe storage until 2085, at which time decontamination and dismantlement will be completed.

BPA

BPA is the largest of the regional federal power marketing agencies within the DOE. It currently markets electric power from 30 federally owned hydroelectric projects, most of which are located in the Columbia River Basin, and from several nonfederally owned and operated projects, including the Columbia Generating Station. BPA sells and/or exchanges power under contracts with more than 100 utilities in the Pacific Northwest and the Pacific Southwest and with several industrial customers. It also owns and operates a high-voltage transmission system comprising approximately 75% of the bulk transmission capacity in the Pacific Northwest. BPA estimates that the electric power sold by it in a 300,000 square-mile service area accounts for approximately 45% of the electric power consumed in the region. Total population serviced approximates 10 million people.

In 1996, BPA separated its power marketing function from its transmission system operation and electric system reliability functions. BPA remains a single legal entity, but it now conducts its business as separate business lines, the power business line and the transmission business line. BPA receives money from the sale of power and the provision of transmission and other services at rates that seek to produce revenues that recover BPA's costs, including its required payment to the U.S. Treasury. Rates are approved by the Federal Energy Regulatory Commission (FERC). Cash receipts are deposited in the Bonneville Fund, which is a separate fund within the U.S. Treasury. From this fund, BPA must first pay all the costs necessary to operate and maintain the federal system, including payments of the net billed bonds. Only after these payments are made may BPA make required annual payments to the U.S. Treasury. BPA met its fiscal-year 2003 U.S. Treasury payment obligation of $1.057 billion in full and on time, including $315 million in principal payments in advance of due dates under BPA's debt-optimization proposal. Not since 1983 has BPA deferred such payment.

BPA's financial success depends on its ability to manage business and financial risks associated with its commercial operations in a changing competitive environment. Most affecting BPA is price risk associated with commodities, natural gas prices and stream flow uncertainty that, in turn, affect the predictability and stability of revenues.

Refunding Program

In the spring of 2000, BPA presented its debt-optimization proposal to Energy Northwest. This involves the extension of the final maturity of outstanding Columbia Generating Station refunding revenue bonds from 2012–2018 through a series of refunding bond issues. Implementation of the Bonneville proposal is intended to provide BPA with cash flexibility in funding planned capital expenditures, allow BPA to advance the amortization of BPA's high-interest federal debt and reduce the agency's overall fixed costs. Energy Northwest, in response to the BPA proposal, developed its 2000 refunding plan, and its executive board formally adopted the plan in October 2000. In September 2001, Energy Northwest adopted an updated refunding plan, including a revision that incorporated the increase in the average life of Project Nos. 1's and 3's net billed bonds as a refinancing program objective for any future refinancing of such bonds.

An additional objective is to advance refund outstanding noncallable net billed bonds.

In addition to the refunding program, in July 2003, Citibank, N.A. extended a line of credit to Energy Northwest for each of the net billed projects pursuant to three separate credit agreements. Under the Project 1, Columbia Generating Station and Project 3 credit agreements, Energy Northwest may borrow up to $55,720,000, $129,030,000 and $63,835,000, respectively, from time to time up to June 25, 2004. Proceeds of advances may be applied to refinance a portion of the cost of the related project by providing a portion of the funds necessary to refund principal and, in some cases, interest on certain prior-lien bonds maturing on July 1, 2004, issued to finance such projects. As of May 1, 2004, significant borrowings had been made. Energy Northwest's obligation to repay advances under a credit agreement is evidenced by a note. Each note is secured on parity with the electric revenue bonds issued by Energy Northwest under the related electric revenue bond resolution. A portion of the proceeds of the series 2004A bonds is to be applied to pay the promissory notes. Energy Northwest expects to enter into updated credit agreements with Citibank, N.A. in July 2004 for the purpose of extending the maturity of the net billed bonds maturing in 2005.

■ Transmission

The federal transmission system is composed of approximately 15,000 circuit miles of high-voltage transmission lines and more than 300 substations that are located in Washington, Oregon, Idaho and parts of Montana, Wyoming and northern California. A southern intertie consists of three high-voltage alternating current (AC) transmission lines and one direct current (DC) transmission line that interconnect the electric systems of the Pacific Northwest and Pacific Southwest. The rated transfer capability of the southern intertie AC in the north-to-south direction is 4,800 mw of capacity and in the south-to-north direction is 3,675 mw. The rated transfer capability of the DC line in both directions is 3,100 mw. BPA is currently considering additional possible transmission investments to ease congestion, integrate new generation and improve reliability. Pursuant to FERC initiatives, BPA and other regional power providers are considering the creation of a regional transmission organization (RTO). BPA's current transmission system investment plan calls for investments of approximately $302 million a year over the four fiscal years commencing Oct. 1, 2003.

Under the Pacific Northwest Electric Power Planning and Conservation Act, BPA is directed to protect, mitigate and enhance fish and wildlife resources to the extent they are affected by federal hydroelectric projects on the Columbia River and its tributaries. BPA's fish and wildlife costs fall into two main categories, direct costs and operational effects. The agency estimates that the aggregate total of direct and replacement power costs (the latter included in operational effects) totaled approximately $440 million in fiscal-year 2003. In December 2000, a new biological opinion that superseded all previous opinions was issued concerning the federal system hydroelectric dams. This opinion has been coordinated with a fish and wildlife service biological opinion issued in 2000 relating to certain other species, and the opinions are intended to be mutually consistent. Given the complexity of these and other related issues, BPA can gauge the future costs of these programs, but it can provide no certainty as to the scope or cost of future measures to protect fish and wildlife affected by the federal system and other related parties.

■ BPA Subscription Strategy

Under a power marketing approach begun in 1997, BPA proposed to subscribe access to federal system electric power under long-term contracts to its regional customers for the period after Oct. 1, 2001. Under the subscription strategy, BPA entered into long-term contracts through which it has agreed to sell all of its available firm power to regional customers for various terms. Pursuant to the subscription strategy, the agency entered into power sales contracts directly or indirectly to provide power to meet loads of approximately 135 preference customers. With the exception of eight contracts, which have terms of five years, such agreements have terms of 10 years.

Under the subscription strategy, BPA sells preference customers three basic power products: block sales (under which BPA provides five-year fixed blocks of power at agreed times on a take or pay basis), slice of the system (a form or requirements service in which BPA sells a proportion of federal system output, both firm power and seasonal surplus energy, in return for a promise of the customer to pay a correlative proportion of the cost of the federal system) and partial and full-requirements products. Under these agreements, BPA is obligated to provide approximately 6,300 average mw to meet preference customer loads over the remaining term of the five-year period beginning Oct. 1, 2001. Of this amount, approximately 1,600 average mw is sold as slice of the system products, approximately 1,900 average mw is in the form of block sales and the remainder is in the form of requirements products.

BPA had estimated that its loads for the five years beginning Oct. 1, 2001 (pre-existing obligations during such period plus anticipated subscription loads) could exceed federal system generation resources. The aggregate power sales commitments initially undertaken by BPA under these agreements, together with pre-existing obligations, exceeded the aggregate amount of power from federal system resources and contract purchases by approximately 3,200–3,300 average mw, which was estimated at the time to be approximately 8,000 firm average mw.

To meet a portion of this difference, BPA entered into a number of power purchases to augment federal system generation resources (augmentation purchases). Given the very high energy prices prevailing at the time, BPA also negotiated a number of load-reduction agreements with customers, extending through 2006. Approximately 700 average mw of the load reductions are in effect through fiscal-year 2006. In view of the augmentation purchases and load-reduction agreements, lowered expectations regarding regional load growth and the poor outlook for the aluminum industry, BPA now believes that firm resources, including purchases, could exceed firm load obligations in fiscal-years 2004–2006.

Power Marketing After Fiscal-Year 2006

After fiscal-year 2006, BPA faces some uncertainty with regard to the amount of power loads it will be required to meet and the amount of power it may have to obtain in addition to existing federal system generating resources. BPA currently has approximately 1000 mw of augmentation purchases, which will expire at or near the end of fiscal-year 2006. Also, all of the remaining contractually committed take-or-pay power purchases by aluminum company direct-service industries (DSIs) will expire around that time. Other contractual sales arrangements also end around then.

In view of the uncertainties surrounding the period after fiscal-year 2006, in calendar-year 2002, BPA and its customers initiated a regional discussion. This dialogue seeks to address BPA's role in meeting regional load obligations in the future. In the context of these discussions, BPA has indicated to regional customers that it should not be placed in the position of attempting to acquire a substantial portion of the region's power needs, as occurred in calendar-year 2001 during the West Coast crisis. As a means of balancing its statutory obligation to meet loads placed on it by preference and regional investor-owned utility (IOU) customers with the goal of low, stable power rates, BPA indicated to the Pacific Northwest Electric Power and Conservation Planning Council that BPA would prefer to have customers in the region assume the role of meeting incremental power needs. BPA also stated that it viewed positively a council proposal to limit the amount of firm power sales BPA makes at embedded cost rates to approximate the output of the existing federal system. BPA also said that a "tiered rate" design for the subscription power sales in the period after 2006 would be a means of achieving this end. Under tiered rates, costs of new power purchases above the existing federal system generating resources would not be melded with the comparatively low embedded costs of federal system resources. Rather, the costs of the new power purchases would be separately recovered under an additional power rate or rate mechanism from that customer.

■ Electric Rates

Coinciding with the development of new power sales contracts under the subscription strategy in fiscal-years 2000–2001, BPA developed new power rates for the five-year period beginning Oct. 1, 2001. Under the rate proposal, BPA proposed "base rates" that are subject to three intrarate-period rate-level adjustments that are triggered upon the occurrence of specified circumstances. While the base rates are low relative to the cost of most other power generation in the Northwest, the triggering of the adjustment mechanisms has had the effect of raising BPA's rates substantially. FERC approved the proposed 2002 final power rates, including the base rates and the rate-level adjustment mechanisms, on July 21, 2003. FERC's review and confirmation of the 2002 final power rates are subject to legal challenge in the Ninth Circuit Court, and a number of customers have challenged approval of the 2002 power rates in that court.

Under the first of the rate-adjustment mechanisms, the load-based cost-recovery adjustment clause (LB-CRAC), BPA makes semiannual adjustments to rate levels tied to the direct cost of certain augmentation purchases and load-reduction agreements entered to address the increment of loads assumed by BPA under the subscription strategy. The LB-CRAC is based on periodic forecasts of BPA's subscription augmentation costs for consecutive six-month periods during the five-year rate period. The second rate-level adjustment, the financial-based cost-recovery adjustment clause (FB-CRAC), provides one-year adjustments in rate levels in addition to the LB-CRAC. The FB-CRAC is intended to increase rate levels to obtain limited amounts of revenues in a fiscal year if BPA forecasts its power business line to accumulate net revenues below fiscal-year threshold levels. The third rate adjustment, the safety net cost-recovery adjustment clause (SN-CRAC), allows BPA to increase rate levels to recover costs if at any time during the rate period BPA were to forecast a 50% probability or greater of missing a scheduled payment to the U.S. Treasury or other creditor or miss a scheduled payment to the U.S. Treasury or other creditor. Under the 2002 final power rate proposal, BPA determines the level of the SN-CRAC in a record of decision after a brief formal rate-setting process. Rate-level increases under the LB-CRAC and FB-CRAC are currently in effect. BPA also has initiated actions that will lead to the formal process needed to increase rate levels under the SN-CRAC.

BPA's Financial Results

Fiscal-Year 2003

For fiscal-year 2003 (Sept. 30), BPA had positive net margins of approximately $555 million. However, absent the net revenue effects of the debt optimization proposal and other debt-management actions relating to Energy Northwest, BPA had net revenues of $37 million. In addition, BPA had $511 million in fiscal year-end financial reserves. Of that amount, approximately $233 million are attributable to actions taken throughout the fiscal year to assure financial liquidity. These actions deferred payments into the future, creating future cash obligations and delaying cash disbursements. By comparison, in fiscal 2002, BPA recorded net revenues of approximately $9.5 million. However, BPA recorded a net operating loss of approximately $348 million after excluding the positive effects of debt optimization and Energy Northwest's debt-management actions. BPA closed fiscal-year 2002 with financial reserves in the amount of approximately $188 million.

Several factors contributed to BPA's financial performance in fiscal-year 2003. First, with indications in early 2002 that revenues from discretionary power sales would be lower than forecasted, BPA began reducing costs substantially. This continued in 2003 through expense reductions, deferrals and other actions, reducing costs by approximately $200 million. BPA expects that the cost-reduction program will improve its power business-line financial condition by $350 million in aggregate over fiscal-years 2003–2006. Second, in fiscal-year 2003, BPA received a total of approximately $175 million of U.S. Treasury repayment credits, primarily relating to BPA costs incurred for fish and wildlife expenditures, including power purchases made to assist in fish-related programs. Third, BPA implemented the FB-CRAC rate-level adjustment for all of fiscal-year 2003. This allowed BPA to recover approximately $90 million in additional revenues in fiscal-year 2003 after including certain effects related to the slice of the system contracts. Fourth, after taking into account the effects of the various rate-level adjustments under the final 2002 power rate proposal, BPA's affected subscription power rates in fiscal-year 2003 remained at levels comparable with those in effect in fiscal-year 2002. Fifth, despite below-average water conditions (85% of average), BPA's revenues from discretionary power sales increased because of higher market prices for such power to $37 per mwh in fiscal-year 2003 from $26 per mwh in fiscal-year 2002.

Financial Summary — Bonneville Power Administration

($ Mil., Years Ended Sept. 30)

	2003	2002	2001	2000	1999
Income Statement					
Total Operating Revenues	3,612	3,534	4,279	3,040	2,619
Total Operating Expenses	2,711	3,172	4,116	2,465	2,140
Operating Income	901	362	163	575	479
Adjustments to Operating Income for D/S Coverage	270	565	796	881	960
Income Available for D/S	1,171	927	959	1,456	1,439
Nonfederal Projects Annual D/S*	120	230	473	561	651
BPA Aggregate Annual D/S, Including ENW	842	769	812	1,104	1,212
Selected Balance-Sheet Items					
Unrestricted Cash and Investments	503	235	667	848	685
Restricted Cash and Investments	—	—	—	—	—
Total Debt	15,300	15,162	15,280	15,817	16,101
Equity and/or Retained Earnings	344	(221)	132	(108)	(231)
Key Ratios					
Nonfederal Projects D/S Coverage (x)	9.76	4.03	2.03	2.60	2.21
BPA Aggregate D/S Coverage (x)	1.39	1.21	1.18	1.32	1.19
Days Cash on Hand	75.2	32.9	73.3	195.4	211.9
Operating Margin (%)	24.9	10.2	3.8	18.9	18.3
Equity/Capitalization (%)	2.2	(1.5)	0.9	(0.7)	(1.5)

*Includes some nonfederal project debt not associated with ENW. D/S – Debt service. BPA – Bonneville Power Administration. ENW – Energy Northwest. Note: D/S coverage is calculated as financial coverage, not resolution/indenture coverage. Source: Comprehensive annual financial report.