



Department of Energy

Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208-3621

POWER BUSINESS LINE

June 18, 2004

In reply refer to: P-6

Dear Rate Case Parties, Customers, Constituents, Tribes and Others:

As you know, Bonneville Power Administration (BPA) power rates remain at levels that are creating economic distress for many of our customer utilities and their customers. We have been working hard, along with our customers, our generating partners, and many others in an attempt to bring rates down this fall. Those efforts come to a head this September, when BPA sets the Financial-Based Cost Recovery Adjustment Clause (Financial-Based CRAC) and the Safety Net Cost Recovery Adjustment Clause (Safety Net CRAC). These rate adjustments will determine the level of BPA's wholesale power rates for FY 2005, which take effect this October 1. Because this is such a significant decision, we would like to know what you think about the choices at hand before offering our proposal later this summer. We have heard clearly from many customers that BPA should make rates this October as low as possible, preferably by eliminating the Safety Net CRAC for FY 2005. We have this thought firmly in mind, and look forward to additional input on the analysis and choices.

Background

Over the last year, major cost reductions have been achieved in two key areas. First, agreements with the region's investor-owned utilities have reduced BPA's costs by over \$200 million for FY 2005 and 2006, which has reduced the Load-Based CRAC that goes into effect in October. And, the Power Net Revenue Improvement Sounding Board has helped BPA identify \$110 million in expense reductions and revenue enhancements for FY 2004 and 2005.

These savings are significant. In addition, proposed changes to summer spill, if approved, could produce an additional \$20 to \$31 million in net revenues for FY 2004. These additional revenues would be particularly critical to the rate decision this September because they would be dollars we can count on this year. The decision on summer spill will not be known until later this summer. Looking forward, forecasts of natural gas prices for 2005 and 2006 are high, creating expectations for high net secondary revenues in those years. On the other side of the ledger, this year is the fifth year in a row of below-average January through July run-off and concludes the second lowest set of four consecutive water years on record. This year's low run-off is expected to result in a drop of over \$100 million in net secondary revenues relative to the forecast in the Safety Net CRAC rate case of August 2003.

Because low water is hurting this year's financial results, setting the Safety Net CRAC based only on this year's financial performance would probably mean a higher Safety Net CRAC than expected previously, which would likely lead to an increase in power rates in October. However, the BPA Administrator has the discretion to "look forward" and consider forecasts of PBL's financial performance for FY 2005 and FY 2006 when deciding on the FY 2005 Safety Net CRAC. The limit

on this flexibility is that BPA's two-year Treasury payment probability must not drop below 86.2 percent. Using this flexibility would allow the Administrator to lower the Safety Net CRAC in 2005, potentially all the way to zero, which in turn could mean no rate increase in October, or even a rate decrease.

Decision Process and Request for Input

The administrator is inclined to use this discretion. But the final decision as to whether to use this discretion, and to what extent, will be based on the outcome of the ongoing decision process on summer spill, the third quarter financial results for FY 2004, forecasts of gas prices and net secondary revenues for 2005 and 2006, forecasts of other costs and revenues for 2005 and 2006, Treasury Payment Probability estimates at various rate levels, and input from customers, constituents and others on all of the above.

As a basis for your comments, we will share our draft estimates of all this information. These materials will be available on June 25, 2004 at www.bpa.gov/power/rates. We will be seeking comment based on these materials throughout the month of July.

We will hold a workshop to discuss these materials and answer questions on July 1, 2004. The workshop will begin at 9 a.m. in the Rates Hearing Room, Room 223, which is located at 911 NE 11th Avenue, Portland, Oregon. If you would like to participate by telephone, please call Cain Bloomer at (503) 230-7443 or Cynthia Jones at (503) 230-5459 to be connected to the conference bridge.

In addition, there will be a second workshop in mid-August where we will propose the Financial-Based and Safety Net CRAC rate adjustments for FY 2005, which will be followed by a second comment period focused on the actual proposed rate adjustments. The administrator will make his final decision on these rate adjustments for FY 2005 by mid-September.

I want to repeat that input from customers and other regional stakeholders is important to this upcoming decision. In addition to the meetings described above, BPA's Account Executives are available for discussions and to take your input. Comments can also be sent to comment@bpa.gov. Additional questions or comments can be directed to Byron G. Keep, Rates Manager, at (503) 230-5660 or me at (503) 230-5399. Written comments can be sent to the following address.

Bonneville Power Administration
P. O. Box 14428
Portland, OR 97293

Thank you for your consideration of this important matter. We look forward to hearing from you.

Sincerely,

/s/ Paul E. Norman

Paul E. Norman
Senior Vice-President
Power Business Line