BONNEVILLE POWER ADMINISTRATION

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Power rates drop as BPA enters last of five-year power rate period

For the third consecutive fiscal year, BPA is dropping its wholesale power rates. Fiscal year 2006 rates will average 1.6 percent lower than the previous year's rate. The exception is for Slice customers, who purchase power under a different set of rates (see below). The 2006 rate, effective Oct. 1, 2005, is the final year of a five-year rate period.

This year's decrease comes after extraordinary challenges. It is the sixth year in a row of below average water. Also, while the final figures are not yet in, additional water spilled for endangered and threatened salmon will likely have cost BPA tens of millions of dollars.

Key factors contributing to the rate decrease

After a dry winter and early spring, the region experienced above-average precipitation in late spring and early summer. While the Janurary through July run-off season was only 76 percent of average, the late precipitation helped offset some of the dry year impacts.

The late spring rains came at a time when market prices were moving upwards. High natural gas prices, a tight supply picture in the West and hot weather combined to keep wholesale power prices unusually high throughout the summer. Traditionally, revenues from surplus power sales have represented from 20 percent to 25 percent of BPA power revenues. These revenues are critical to keeping Northwest rates down.

During the low-water period, BPA hydro operators managed the hydro system judiciously, and the agency's power traders worked to make market choices that would benefit the region.

BPA continued a stringent cost management program to reduce costs. Working with its partners (the Corps of Engineers, Bureau of Reclamation and Energy Northwest), BPA has captured hundreds of millions in savings over costs projected in 2002. A customer sounding board also helped BPA identify additional cost reductions and revenue enhancements for fiscal years 2004-2005. The result was $111 million identified savings. And, BPA has been successfully holding its power-related internal operating costs to 2001 actuals on average through the rate period with no increase for inflation.

Why a cost-recovery adjustment

The rate includes an adjustment under the Safety Net Cost Recovery Adjustment Clause.

At the beginning of the current five-year rate period, BPA adopted a series of cost recovery adjustment mechanisms known as CRACs. These mechanisms were recommended by customers as a means of keeping base rates lower. Without the ability to make adjustments based on changing load and financial conditions, it would have been necessary to set the rates higher to take into account the risk of changing conditions to ensure BPA could cover its costs and meet its U.S. Treasury payment.

For the 2005 fiscal year, the BPA administrator used his discretion to forego implementing the Safety Net CRAC to help the regional economy. This was possible because, with another year ahead in the rate period, there was the reasonable potential for better conditions. For 2006, however, the administrator did not zero out the Safety Net CRAC. That decision is based on the risks the agency faces now and through FY 2006.

BPA's rate provisions say that the administrator must be able to conclude that the agency's probability of making its annual U.S. Treasury payment is above 92.8 percent in order to zero out the Safety Net CRAC. The uncertainties BPA faces in FY 2006 create a likelihood that the probability of payment would be well below that threshold without the Safety Net CRAC. Without it, the rate would have been another 1 percent lower.

What risks does the agency face

There is always the possibility of another below-average water year.

Market volatility continues, and high prices could help or hurt BPA depending on whether the agency is a buyer or seller.

BPA is exposed to potential additional costs from pending litigation over the FY 2002 Slice true-up and litigation over hydro operations on behalf of Endangered Species Act-listed fish (the biological opinion). The latter could be extremely costly if the court orders additional spill and flow augmentation.

One public utility has requested "residential exchange" benefits from BPA, a program under which utilities with higher average system costs trade their higher cost power for BPA's lower cost power (generally, this is a financial transaction rather than a power exchange). The savings must be passed on to the utilities' residential and small-farm consumers. Other public utilities could seek exchange rights, which would increase expenses.

Slice customers

A group of customers has chosen to purchase a Slice product from BPA that is best described as a "slice" of the generation output of the federal system. The Slice product includes service to net requirements firm load as well as an advance sale of surplus power. By purchasing this product, the customers assume both the risks and benefits of the system. They manage their proportionate share of the risks associated with variable water volume and price for secondary sales rather than paying BPA a risk premium to manage those risks on their behalf.

As for benefits, Slice customers should benefit from the sale of their surplus power about the same way BPA benefits from its sales of surplus power. Therefore, the Slice customers' effective Slice rate will depend on the extent of each customer's success in managing the risks associated with its sales of surplus power. Slice customers will see the announced 1.6 percent rate decrease *only* in their block purchases, which are priced separately from the Slice product. As for the Slice product, any changes to the costs of operating the federal hydro system will be reflected in the upcoming Slice true-up.

A caveat

Even though rates will drop by 1.6 percent this October, the true-up for the Financial-Based Cost Recovery Adjustment Clause comes into play after BPA receives the audited actuals for fiscal year 2005. If the net difference between the numbers used to calculate the Financial-Based CRAC varies from the audited actuals by more than $5 million either way, the adjustment must be trued-up. This has the potential to adjust the Financial-Based CRAC rates either up or down for April through September.

New rate period coming

While fiscal year 2006 is the end of the current wholesale power rate period, BPA and its customers have been looking ahead. The agency has been holding informal workshops this past summer preparatory to a formal rate case covering fiscal years 2007-2009. Later this fall, BPA will publish an initial rate proposal for this new three-year rate period. BPA expects to keep rates well below the market price for power during that period as well. BPA's financial performance and ending cash reserves for fiscal year 2006 will have a direct bearing on the level of fiscal year 2007-2009 rates.