



Research

Energy Northwest, Washington Bonneville Power Administration, Oregon; Retail Electric; Wholesale Electric

18-Feb-2010

[Current Ratings](#)

Credit Profile

US\$309.77 mil elec rev rfdg bnds (Bonneville Pwr Admin) (Proj 3) ser 2010-A&B

<i>Long Term Rating</i>	AA/Stable	New
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US\$89.275 mil columbia generating sta elec rev rfdg bnds (Bonneville Pwr Admin) ser 2010-B&C

<i>Long Term Rating</i>	AA/Stable	New
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US\$77.185 mil elec rev rfdg bnds (Bonneville Pwr Admin) (Proj 1) ser 2010-A&B

<i>Long Term Rating</i>	AA/Stable	New
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Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

+ Bonneville Pwr Admin elec rev rfdg bnds

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long-term rating to the following proposed **Energy Northwest** (ENW), Wash.'s revenue and refunding bonds:

- \$68.3 million Project 1 electric revenue refunding bonds series 2010-A
- \$289.1 million Project 3 electric revenue refunding bonds series 2010-A
- \$8.9 million Project 1 electric revenue refunding bonds series 2010-B
- \$16.8 million Columbia Generating Station electric revenue refunding bonds series 2010-B
- \$20.7 million Project 3 electric revenue refunding bonds series 2010-B
- \$72.5 million Columbia Generating Station electric revenue bonds series 2010-C (taxable Build America Bonds)

The outlook is stable.

Except for the 2010-C new money bonds, ENW is selling the bonds to refund obligations outstanding. The bonds' debt service is payable as a **Bonneville Power Administration** (BPA or Bonneville), Ore., operating expense.

The ratings we assigned to the ENW and other nonfederal debt paid as a Bonneville operating expense do not constitute an issuer credit rating on BPA and are not an assessment of its capacity to meet federal and nonfederal obligations.

Standard & Poor's also affirmed its 'AA' long-term rating on the several nonfederal debt obligations that BPA pays as operating expenses of its electric system. The BPA nonfederal obligations include:

- \$5.9 billion of ENW, Wash.'s revenue and refunding bonds;
- \$127.8 million of Public Utility District No. 1 of Lewis County, Wash.: Cowlitz Falls Project bonds;
- \$119.6 million of Northwest Infrastructure Financing Corp. (Schultz-Wautoma project) bonds;
- \$23.8 million of Northern Wasco Public Utility District, Ore. (McNary Dam Project) bonds;
- \$16.1 million of Conservation and Renewable Energy bonds; and
- \$9.6 million of Tacoma, Wash., Conservation System Project bonds.

The 'AA' ratings on the BPA-supported, nonfederal debt, reflect our view of the following credit strengths:

- A track record of strong coverage of nonfederal debt service;
- The seniority of the \$6.6 billion of ENW and other nonfederal debt relative to the \$6.5 billion of federal debt;
- The nearly 1-to-1 ratio of nonfederal-to-federal debt, which facilitates debt service coverage of at least 2x for the nonfederal bonds so long as BPA's rates meet all financial obligations, including the federal debt;
- The ability to defer federal debt repayments, if necessary;
- Bonneville's strong liquidity for the ratings in the past five years, which provides a cushion against highly variable hydrology conditions and tempers the financial impacts of the regulatory lag inherent in biennial rate cases;
- The strong, efficient, and economical operations of the federal Columbia River Power System (FCRPS), which fosters strong demand for the output of the combined FCRPS hydroelectric projects and ENW nuclear production;
- The broad service territory's large number of customers; and
- New, 20-year contracts with BPA and its customers, demonstrating the customer base's commitment to Bonneville's system.

Standard & Poor's also incorporates the following exposures in the ratings:

- Financial performance hinges on hydrology conditions that can impair surplus power sales revenues and require replacement power purchases that add to expenses, as occurred in 2009 and as BPA projects will recur to a greater extent in 2010.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility.
- BPA's new customer contracts do not establish rates and it will need to rely on future rate proceedings.
- We believe Bonneville is exposed to volatile wholesale power markets because customer needs exceed FCRPS and ENW's output, which leads to market power purchases.
- Weak market power prices, like those of 2009, could compromise revenues from surplus energy sales.
- BPA is projecting \$4 billion-\$5 billion of capital needs through 2014, beyond ENW's capital needs, which will add to debt.

Bonneville markets electricity from 31 federal hydroelectric projects; ENW's nonfederal, nuclear Columbia Generating Station; and several nonfederal small power plants. It also operates an extensive transmission system that facilitates power marketing activities that accounted for about one quarter of 2009's operating revenues. Its transmission system represents about 75% of the Pacific Northwest's transmission capacity.

BPA treats debt service on its \$6.6 billion of nonfederal debt as an operating expense. It pays nonfederal debt ahead of debt service on \$6.5 billion of federal debt. Federal debt includes bonds issued to the U.S. Treasury and federal appropriations that Bonneville must repay with interest.

BPA can defer its federal debt payments if after paying operating expenses, including the nonfederal debt, it cannot meet

its total obligations. However, in the first instance, it is legally required to establish rates that it projects will cover all operating expenses, and federal and nonfederal obligations. Moreover, interest accrues on deferred federal debt repayments.

In the event of financial shortfalls that exceed defined thresholds, BPA has a cost recovery rate adjustment mechanism available to make limited rate adjustments without initiating protracted rate proceedings. It revisits base rates every two years.

About 80% of the power BPA sells is hydroelectric. Its hydroelectric resources' performance hinges on hydrology conditions. Hydrology conditions were 18% below the 30-year historical average in 2009 and BPA projects hydrology conditions 26% below the historical average in 2010.

Bonneville has also committed to pay for the output of ENW's single operating nuclear plant and to support the debt of two other nuclear plants that are unfinished or dormant. Nuclear electricity production accounts for 9%-12% of electricity sales. The lower end of this range reflects years with refueling outages. The Columbia Generating Station nuclear plant had five unplanned shutdowns in 2009. We view the repeated outages as creating the potential for higher costs at a utility that only revisits base rates every two years. Nevertheless, BPA's unconditional obligation to service ENW's debt mitigates some of our concerns.

Because only one nuclear plant, the Columbia Generating Station, also supports the debt of nonoperating nuclear plants, the resulting debt per kilowatt (kW) for the Columbia Generating Station's 1,157 megawatt (MW) capacity is very high, in our view, at nearly \$5,700 per kW. The debt burden would have been lower but for the BPA-initiated debt optimization program. This program reduced Bonneville's overall debt obligations by accelerating some federal debt while deferring ENW debt for payment in later periods.

The combination of low-cost FCRPS hydroelectric production and the Columbia Generating Station's sound operations give BPA the ability to maintain very competitive wholesale rates for its customers. The current rate for preference customers is 2.8 cents per kilowatt-hour for FCRPS and ENW power. Bonneville implemented this level of rates in October 2009 and projects these rates will remain in effect through September 2011, even though it faces poor hydrology conditions.

We believe accrual coverage of non-federal debt service was very strong in 2005-2008, equaling at least 4.3x. In 2009, coverage of non-federal debt was markedly weaker, but nevertheless strong at 2x. Nonfederal debt service coverage in 2009 reflected poor hydrology conditions that limited surplus sales. Furthermore, weak natural gas prices eroded wholesale market prices for the surplus electricity that was available for sale.

Accrual debt service coverage of combined federal and nonfederal obligations fell to what we consider a merely adequate 1.0x in 2009 from 1.1x in 2008 and 1.2x in 2007. Cash basis debt service coverage in 2009 was 0.8x, which was accompanied by a nearly \$360 million draw on unrestricted cash and investments in fiscal 2009. BPA projects another weak hydrology year for 2010, which we believe could further erode coverage and lead to additional draws on cash reserves. Unrestricted cash and investments of \$1.37 billion at fiscal year-end 2009 represented more than six months' operating expenses, which we view as robust and provides a cushion for responding to the weak hydrology conditions.

In February 2009, the federal stimulus package raised BPA's debt ceiling \$3.25 billion to \$7.70 billion. As Bonneville adds more federal debt and nonfederal debt amortizes, the budgetary directive that BPA cover all of its debt and expense obligations should translate into stronger coverage of its nonfederal obligations.

Outlook

The stable outlook reflects our assessment of the cushion that the Treasury debt provides to the ENW and other nonfederal debt and a lengthy track record of timely Treasury payments. The outlook also reflects the availability of the cost recovery adjustment clause and strong liquidity as buffers against BPA's exposure to hydrology conditions and wholesale power markets. Exposure to hydrology conditions and wholesale markets constrains upside rating potential and could potentially erode credit quality.

Strong Liquidity For The Ratings

BPA's liquidity benefits from its customers' migration to a direct pay system that modifies the historical net billing arrangement. Under the net billing arrangement, customers remitted funds to ENW, rather than to Bonneville. ENW paid BPA only after it had fully funded its annual debt service and operations and maintenance (O&M) obligations. This typically took about four months. Under the direct pay arrangement, customers pay BPA directly and it makes monthly payments to ENW to cover its debt service and O&M, leaving BPA with stronger liquidity. Direct payments to BPA enhanced its liquidity.

BPA had unrestricted cash of nearly \$1.4 billion at fiscal year-end 2009, down from \$1.7 billion at fiscal year-end 2008. Even with the decline, liquidity represented what we view as a strong 57% of annual operating expenses in 2009, compared with 79% of annual operating expenses in 2008. Weak hydrology conditions and soft market prices for wholesale electric sales of surplus power contributed to 2009's demands on liquidity.

Bonneville can defer federal debt maturities in the event of spikes in operating costs and liquidity pressures. The last deferral was in 1983.

Limited Rate Oversight

BPA develops its rate proposals as part of biennial rate proceedings. It implements the rate proposals after the Federal Energy Regulatory Commission confirms compliance with federal statutory requirements, such as sufficiency to meet all financial obligations. The biennial rate-setting process solicits input from regional stakeholders, which translates into a lengthy and a typically, politically charged process. Stakeholders include customers, environmental agencies, and numerous interested parties. The revised rates BPA implemented in October 2009 are scheduled to remain in effect through September 2011.

A cost recovery adjustment clause that took effect Oct. 1, 2006, enabled BPA to increase rates up to \$300 million, or about 10%, each year, to account for wholesale revenue shortfalls. In 2010, BPA raised the trigger from a \$300 million shortfall to about \$700 million to reflect the benefits of the \$750 million U.S. Treasury credit line that can be used to cover shortfalls. The adjustment mechanism's formulaic nature mitigates the risks of the lengthy review process. However, the higher trigger and Bonneville's decision to address the 2009-2010 hydrology conditions in its next biennial rate proceeding introduce regulatory lag that dilutes its financial flexibility.

Customers accepted a contract that will take effect in 2011. BPA expects that the contracts will help it to better manage its supply obligations and financial exposures to market costs for wholesale power. Bonneville customers will pay tiered rates after current contracts expire in 2011. Although future proceedings will set the precise rates, BPA and its customers have agreed on a rate structure in which a first tier would reflect the cost of FRCPS and ENW energy and limited supplemental market power. Under a second tier, customers will pay market prices for energy needs beyond FRCPS and ENW capabilities. The tiered rate structure focuses on providing equitable cost allocation among customers by requiring Bonneville's fastest growing customers to shoulder BPA's costs of securing additional energy and capacity resources to meet these customers' needs. This rate structure should shield slower growth customers from socialized costs. It should be revenue neutral to BPA. A number of customers commenced legal proceedings challenging the revised rate structure.

BPA is legislatively mandated to share benefits of its low-cost power with regional investor-owned utilities' residential and small-farm customers. The extent of cost- and benefit-sharing between preference customers and investor-owned utility

customers is the subject of lengthy litigation. The outcome of these disputes should be revenue neutral for BPA, because its rates must cover all costs irrespective of allocation among different groups. Nevertheless, the legal wrangling is a credit concern, because it places meaningful demands on management.

Markets: Large And Diverse Customer Base

BPA's wholesale customers include public utilities, public utility districts, municipal districts, cooperative utilities, and investor-owned utilities. It first offers surplus energy to customers and then to other utilities in the West. Surplus sales' margins offset operating costs.

A large customer base includes 61 cooperative utilities, 17 federal agencies, 14 investor owned utilities, 48 power marketers 53 municipalities and 30 public utility districts, among others. Favorable project economics create strong demand for FCRPS and ENW generation, which contributes to a secure revenue stream and credit quality. In fiscal 2009, customers entered 20-year contracts that will replace 10-year contracts expiring in 2011.

Operations: Large Operational Diversity

The FCRPS hydroelectric capacity exceeds 21,000 MW and is spread over 206 generating units, which provides for tremendous operational diversity. However, the sustained peak capacity of the hydroelectric system is a meaningfully lower 12,700 MW. These resources are exposed to hydrological conditions that can impair operational and financial performance by reducing hydroelectric output. Fish migration needs and flood control can also constrain hydroelectric production.

ENW's Columbia Generating Station provides 1,157 MW of capacity and exhibits strong availability and capacity factors between refueling cycles. The nuclear plant is refueled every other year. Nuclear electricity production accounts for 9%-12% of electricity sales. The lower end of this range reflects years with refueling outages.

ENW's \$5.9 billion of debt is associated with only the 1,157 MW of operating nuclear capacity. By comparison, 21,000 MW of hydroelectric capacity bears \$6.5 billion of federal debt. Therefore, the debt service costs per megawatt-hour of nuclear production are about 7x-8x the cost of hydroelectric production. The debt burden would have been lower but for the BPA-initiated debt optimization program. This program reduced Bonneville's overall debt obligations by accelerating federal debt while deferring ENW debt for payment in later periods.

Related Research

USPF Criteria: [Electric Utility Ratings](#), June 15, 2007

Ratings Detail (As Of 18-Feb-2010)

Conservation and Renewable Energy Sys, Washington

Bonneville Pwr Admin, Oregon

[Conservation & Renewable Energy Sys \(Bonneville Pwr Admin\) conserv proj](#)

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

[Energy Northwest elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018](#)

<i>Long Term Rating</i>	AA/Stable	Affirmed
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[Energy Northwest elec rev rfdg bnds \(1,columbia,3\) ser 2004AB&C dtd 06/02/2004 due 07/01/2007-2018](#)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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[Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg](#)

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating St, & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin) ser 2006 A-D

Long Term Rating AA/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate ser F-1 ser 2008-F

Long Term Rating AA/A-1/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate ser F-2 ser 2008-F

Long Term Rating AA/A-1/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate subseries F-1 (Bonneville Pwr Admin) ser 2008-F dtd 06/17/2008 due 07/01/20

Long Term Rating AA/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate subser F-2 (Bonneville Pwr Admin) ser 2008-F dtd 06/17/2008 due 07/01/2018

Long Term Rating AA/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) rfdg rev bnds (Bonneville Pwr Admin-Nuclear Proj #1 & #3) ser 1993C dtd 09/01/1993 due 07/01/1996 1999 2002-20

Unenhanced Rating AA(SPUR)/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) rfdg rev bnds (Nuclear Proj #2) ser 1993A dtd 05/01/93 due 07/01/1994-1998 2000-2002 2004-2007 2009-2010 2012

Unenhanced Rating AA(SPUR)/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) Sub Lien

Long Term Rating AA/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) (MBIA) (AGM)

Unenhanced Rating AA(SPUR)/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)

Long Term Rating AA/Stable Affirmed

Energy Northwest (Bonneville Pwr Admin) (1,Columbia,3)

Long Term Rating AA/Stable Affirmed

+ Bonneville Pwr Admin elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Bonneville Pwr Admin elec rev rfdg (Colu)

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin)

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Energy Northwest (Bonneville Pwr Admin)

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Energy Northwest (Bonneville Pwr Admin) (XL Capital Assurance Inc.)

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Washington Pub Pwr Supp Sys (Bonneville Pwr Admin) (Nuclear Proj 1-3) rfdg rev bnds ser 1997A dtd 09/01/1997 due 07/01/2008-2017

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Washington Pub Pwr Supp Sys (Nuclear Proj #3) rfdg rev bnds ser 93C dtd 9/23/93 due 7/1/2013 2014 2015 2017(CUSIP #939830RW7 RY3 RX5 RZ0)

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Washington Pub Pwr Supp Sys (Nuclear Proj #3) (Bonneville Pwr Admin)

Unenhanced Rating AA(SPUR)/Stable Affirmed

Lewis Cnty Pub Util Dist #1, Washington

Bonneville Pwr Admin, Oregon

Lewis Cnty Pub Util Dist #1 (Bonneville Pwr Admin) (Cowlitz Falls Hydroelec Proj) ser 1991 1993 2003

Long Term Rating AA/Stable Affirmed

+ Lewis Cnty rev rfdg bnds (Bonneville Pwr Admin) (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2007-2012

Unenhanced Rating AA(SPUR)/Stable Affirmed

+ Lewis Cnty (Bonneville Pwr Admin) rev rfdg bnds (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2013-2024

Unenhanced Rating AA(SPUR)/Stable Affirmed

Northern Wasco Cnty Peoples Util Dist, Oregon

Bonneville Pwr Admin, Oregon

Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)

Long Term Rating AA/Stable Affirmed

Northwest Infrastructure Financing Corp., New York

Bonneville Pwr Admin, Oregon

Northwest Infrastructure Financing Corp. (Bonneville Pwr Admin) TRAns

Long Term Rating AA/Stable Affirmed

Tacoma, Washington

Bonneville Pwr Admin, Oregon

Tacoma (Bonneville Pwr Admin) (Pub Util Lt Div Conserv Sys Proj)

Long Term Rating AA/Stable Affirmed

Many issues are enhanced by bond insurance.

Primary Credit Analyst: David Bodek, New York (1) 212-438-7969; david_bodek@standardandpoors.com

Secondary Credit Analyst: Jeffrey Panger, New York (1) 212-438-2076; jeff_panger@standardandpoors.com

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