Global Power/North America
New Issue

Energy Northwest

Bonneville Power Administration

Ratings

New Issue

$320.7 Million Series 2005A and 2005B (taxable) 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 owns and operates the Columbia Generating Station, previously known as Nuclear Project No. 2. BPA purchased 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

- 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. Compares well with higher priced natural gas-fired generation.

Key Credit Concerns

- Volatility associated with hydro-based system.
- Inconsistent financial performance.
- Political and litigation uncertainty.

May 16, 2005

■ Rating Rationale

Fitch Ratings has assigned a ‘AA–’ rating to the series 2005 bonds and affirmed the ‘AA–’ rating on Energy Northwest’s (formerly the Washington Public Power Supply System) 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 U.S. Treasury payments, the importance of the federal power marketing agency in supplying electricity and transmission services in the Pacific Northwest and a more flexible rate-adjustment strategy. The implementation of the three-step, cost-recovery adjustment clauses (CRACs) has provided 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 and should benefit from a rise in natural gas and coal prices. Also, as a federal power marketing agency, BPA has access to lower cost capital and enjoys certain beneficial standing in the financing of its projects.

Credit concerns consist of an extended period of below-normal water conditions, some softness of the regional economy, power price fluctuations and a generally aggressive power procurement strategy. Greater certainty about BPA’s longer term power supply responsibility for the region, a more conservative approach to power supply planning and more predictable financial performance would benefit BPA and potentially result in a higher rating for the Energy Northwest bonds.

■ Security and New Issue Details

Energy Northwest plans to issue approximately $320 million of series 2005 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. The 2005 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 commitments 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 2005 bonds. Citigroup Inc. will act as lead manager for the bonds, and pricing is scheduled for May 17, 2005.

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 19 members, consisting of 16 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 2004, the capacity factor for the plant was 97.9%. 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. The Institute of Nuclear Power Operations (INPO) performed an evaluation of Columbia Generating Station in January 2005. Several strengths were noted, but some areas for improvement were also sighted.

The price of Columbia Generating Station's electricity was $21.85 per megawatt-hour (mwh) during fiscal-year 2004 and is projected at $32.70 per mwh during fiscal-year 2005 due to a refueling outage and a forced outage. 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 (approximately 9,000 average mw under medium water conditions), 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, 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 11 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 2004 U.S. Treasury payment obligation of $1.053 billion in full and on time, including $346 million in principal payments in advance of due dates under BPA's debt-optimization program. 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.

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 has implemented and 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). No decision is expected until late 2007 at the earliest. BPA's current transmission system investment plan calls for investments of approximately $300 million a year over the four fiscal years commencing Oct. 1, 2004. In January 2005, BPA and its transmission customers agreed to a transmission rate increase of 12.5% beginning in late 2006.

■ Fish and Wildlife

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 $479 million in fiscal-year 2004.

In December 2000, a new biological opinion that superseded all previous opinions was issued concerning the federal system hydroelectric dams. A number of parties filed litigation over this opinion. In May 2003, a federal court ruled the 2000 opinion was inadequate and remanded it back to appropriate parties to correct the deficiencies. On Nov. 30, 2004, an updated 2004 biological opinion was finalized, replacing the 2000 opinion. The 2004 opinion calls for multimillion dollar improvements in fish passage facilities at federal dams over the next 10 years plus other enhancements. Federal agencies estimate the total cost at more than $6 billion, approximatley equal to the 2000 opinion cost estimate. The new opinion, similar to the 2000 opinion, does not recommend any breaching of federal dams.

■ 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 five- and 10-year power sales contracts directly or indirectly to provide power to meet loads of approximately 135 preference customers and into five-year contracts with a small number of direct service industries (DSIs).

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 of 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 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 diminished outlook for the aluminum industry, BPA now believes that firm resources, including purchases, could modestly exceed firm load obligations in fiscal-year 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 DSIs and other contractual sales arrangements will expire around that time.

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 interested parties in the Northwest region that it would prefer to have customers in the region assume the role of meeting incremental power needs. BPA also stated that it viewed positively a proposal to limit the amount of firm power sales it makes at embedded-cost rates to approximate the output of the existing federal system.

BPA also stated 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. Under the draft study, BPA proposes not to sell power to DSIs in the period after fiscal-year 2006. However, financial payments roughly equal to the economic value of approximately 500 mw would be made available to these customers.

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. The base rates are between approximately 1.93 cents per kilowatt-hour (kwh) and 2.30 cents per kwh, excluding transmission and depending on type of service. 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. BPA also entered into settlement contracts with all six of the regional IOUs to settle BPA's obligations under the Residential Exchange Program through fiscal-year 2011.

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. BPA now expects the average rate levels in effect in fiscal-year 2005 for subscription power sales will be approximately $30–$31 per mwh, excluding transmission, compared with $33 per mwh in the last six months of fiscal year 2004. As of Sept. 30, 2006, the CRAC rate structure is scheduled to end, and BPA will need to come up with an alternative pricing plan.

BPA's Financial Results

For fiscal-year Sept. 30, 2004, BPA had positive net revenues of approximately $504 million compared with $555 million the year before. However, absent the net revenue effects of the debt-optimization program and other debt-management actions relating to Energy Northwest, BPA had net revenues of $66 million. In addition, BPA had $638 million in fiscal year-end financial reserves. These reserves include cash and deferred borrowing. For the six-month period ended March 31, 2005, BPA estimates net revenues decreased to $238 million from $347 million the year before. Current analysis indicates that stream flow and snow pack conditions will continue to be below-average in operating-year 2005. This will result in diminished amounts of discretionary power sales. However, higher natural gas prices are benefiting the price BPA receives for its surplus electricity. BPA is managing its power supply situation and expects to meet its fiscal year 2005 U.S. Treasury repayment obligation on time and in full.

Financial Summary — Bonneville Power Administration

($ Mil., Years Ended Sept. 30)

	2004	2003	2002	2001	2000
Income Statement					
Total Operating Revenues	3,198	3,612	3,534	4,279	3,040
Total Operating Expenses	2,409	2,711	3,172	4,116	2,465
Operating Income	789	901	362	163	575
Adjustments to Operating Income for Debt-Service Coverage	366	270	565	796	881
Income Available for Debt Service	1,156	1,171	927	959	1,456
Nonfederal Projects Annual Debt Service*	248	120	230	473	561
BPA Aggregate Annual Debt Service, Including ENW	1,126	842	769	812	1,104
Selected Balance-Sheet Items					
Unrestricted Cash and Investments	654	503	235	667	848
Restricted Cash and Investments	—	—	—	—	—
Total Debt	15,854	15,300	15,162	15,280	15,817
Equity and/or Retained Earnings	847	344	(221)	132	(108)
Key Ratios					
Nonfederal Projects Debt-Service Coverage (x)	5.65	9.76	4.03	2.03	2.60
BPA Aggregate Debt-Service Coverage (x)	1.25	1.39	1.21	1.18	1.32
Days Cash on Hand	11.3	75.2	32.9	73.3	195.4
Operating Margin (%)	24.7	24.9	10.2	3.8	18.9
Equity/Capitalization (%)	5.1	2.2	(1.5)	0.9	(0.7)

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