BONNEVILLE POWER ADMINISTRATION

P.O. Box 3621
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To BPA customers, tribes, constituents and interested parties:

Earlier this year we wrote to you describing the fact that we are in the midst of difficult financial circumstances. In fact we are expecting to lose a substantial amount of money for the second year in a row. As a result, we are forecasting that we will end the year with only a small financial cushion in the form of reserves. The prospect of ending the year in a weakened financial position has caused us to perform a substantial effort to look at our revenues and expenses for the 2003-2006 period. This review suggests the strong potential for poor financial results into the future absent significant management action. This letter reports to you on the results of our review and our plans for addressing the problems

First, you may recall that we have multiple rate adjustment clauses that may cause our rates to change every six months. We now expect that, come October 1, our rates will be at about the same level as the current year. Our costs for serving load which is in excess of our resource base (we have about 3,000 megawatts of contract obligation which is beyond our resource base) is falling as market prices have come down. But offsetting that benefit is the fact that our overall financial situation is not good. This is primarily due to the fact that we are a seller this year as water conditions have returned to near normal, but market prices are extremely low.

We have great concern, however, that our 2003-2006 financial review is forecasting that BPA will most likely experience substantial losses through the remaining four years of the rate period absent substantial use of the rate adjustment clauses, cost cuts/increased efficiency or the use of financial tools that generally we have abstained from using.

We have been concerned for a while that this problem may be coming our way. In December we began to focus more seriously on cost management and have taken numerous internal actions to control costs. We have also been testing our contracts to determine where we might be able to reduce costs. For example we have terminated two of our contracts with Enron and have asked the Federal Energy Regulatory Commission to take actions that could allow us to further reduce payments to Enron. While eliminating the Enron contracts is far from a panacea, every little bit helps. Despite our best efforts though, we believe we are still confronted with tough choices.

Ultimately, these are choices that get to our fundamental values as to how the benefits from the Federal Columbia River Power System should be allocated. But we must confront these choices because this system continues, despite its financial difficulties, to provide substantial benefits to the region. It is only by being good financial stewards of the assets and paying the costs of the system that we retain the right to its benefits. Consequently, we believe we need to have a discussion about our priorities as a region.

In entering this discussion, there is a tendency to suggest that certain entities (each group picks somebody different) caused the problem and therefore should bear the brunt of the solution. I know it's impossible to eliminate this, but I hope we can minimize it. I'm hoping we can focus on what our realistic options are for improving the financial health of the system while maintaining our goals to provide public benefits (be they in the form of low rates or program expenditures) to the citizens of the Northwest.

We are providing to the public substantial information about our projections of costs and revenues (see enclosed letter from Paul Norman). We also are providing some illustrative examples of the types of actions we could take based on what we have heard from regional interests. For example, this problem could all be handled through rate increases. Alternatively, a substantial round of cost-cuts could largely dissipate the need for rate increases. Both options create profound impacts on our regional values. We also could choose to seek to push costs into the future or take greater risk with respect to making the annual payment to the U.S. Treasury. I have to admit that I begin this discussion not particularly fond of the latter two alternatives but recognize that there are some in the region who believe this should be on the table.

More important though than the examples is our attempt to describe in a set of key questions the fundamental values that we believe are at stake in this debate. We strongly encourage all interested parties to comment on these key questions or add your own if you believe we have not adequately captured your concerns. While detailed comments are always welcome, it is this kind of conceptual feedback that is likely to be most useful to us as we move toward making decisions toward the end of this year.

Ultimately we have the tools to address this problem. It is our view though that as the stewards of the assets we need your input and would like to create the opportunity for as much regional consensus as possible.

Last year we came through a much more difficult challenge working collaboratively as a region to avert what might have been a triple digit wholesale power rate increase. It confirmed my faith that, so long as we work together, we can meet the challenges of a changing world and, not only preserve, but also enhance the benefits that the federal power system provides to the people of the Pacific Northwest.

We look forward to your comments.

Sincerely,

Stephen J. Wright
Administrator and Chief Executive Officer
Bonneville Power Administration

Enclosure