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December 20, 2005

Dear Northwest ratepayer,

As a signatory to the \$27 in '07 campaign, led by the Northwest Coalition for Affordable Power, you have expressed an interest in the Bonneville Power Administration's upcoming power rate case. This rate proceeding, which began in early November, will determine BPA's wholesale electric power rates for the fiscal year 2007-2009 period.

We applaud your engagement in such an important issue, and, since you have expressed interest in both our rates and costs, we are providing the following information to help you understand what BPA is doing to keep rates down and how you can be involved. While costs of BPA purchases usually make up half or less of a utility's retail sales, we recognize we have an important impact on the Pacific Northwest economy. We also point out toward the end of this letter the single most significant issue that will impact our future rates.

In 2001, BPA was forced to raise power rates substantially due to the West Coast energy crisis and severe drought. Since that time, we have been working hard to lower rates, and I'm proud to say that in each of the last three years BPA has reduced its power rates despite the fact that we have now had six straight years of below average water. Because BPA's power largely comes from hydro-power, low water conditions have a huge impact on our revenues. Nevertheless, we have taken a number of initiatives to offset the impacts of low water so that we can continue to keep rates down. While we are striving for continuous improvement, we know our work is not done.

Exploring cost reductions that could result in rate reductions is a complex area of public policy because it's more than just about getting tough on costs. It is also about the trade-offs that need to be made on important public policy objectives. The following describes key obligations and challenges that must be considered when setting rates.

Defining BPA's core mission

It's important to remember that BPA is a federal nonprofit agency that sells its wholesale power at cost with preference given to the region's consumer-owned utilities. BPA's power is well below the market price, and we are committed to getting power rates as low as possible while still fulfilling our statutory responsibilities to serve the public interest. We passionately believe that affordable electricity rates are critical to our regional economy.

Approximately 90 percent of the power BPA markets comes from the federal hydroelectric system in the Columbia River Basin. We take great pride in being responsible stewards of these assets that are owned by the public. BPA has statutory responsibilities for funding the operation and maintenance of the federal dams and one nuclear plant. Our obligations also include investments in energy efficiency and renewable resources, fish and wildlife mitigation, transmission to assure a reliable electricity supply, and benefits that lower rates for residential and small-farm customers of investor-owned utilities. Our fundamental goal is to manage

these assets to assure they are working to improve the economic and environmental health of our region.

Striving for maximum efficiency

We at BPA know we need to continually seek increased productivity in how we carry out our core mission at the least possible cost. By increasing productivity we can meet our twin goals of providing the services people want and at a low cost. In the last 10 years, the cost of operating our system, which includes the dams (operated by our sister federal agencies, the Corps of Engineers and Bureau of Reclamation), the region's one operating nuclear plant (run by Energy Northwest), plus the associated debt service and our internal operating costs, has increased at roughly a 2.5 percent annual rate, about the rate of inflation. At the same time, we are producing more electricity from this system thanks to investments that enhance productivity. Creating enhanced efficiency is a cornerstone of our responsibility as stewards of these assets.

Internally, we are currently conducting a multi-year efficiency program and have already completed consolidations and reorganizations in five major functions. Our staffing has been declining steadily for the last three years and will continue to do so. We are so confident that our initiatives will further improve efficiency that we have not only reflected progress to date in our initial rate proposal, but we've also assumed additional efficiencies yet to be identified will be implemented. The final rate proposal next June will reflect the additional progress we make over the next six months.

Setting rates to cover costs

As a self-financed agency, BPA gets no annual appropriations from Congress. Therefore, we are legally obligated to set a rate that recovers our costs and ensures we meet our statutory obligations, as outlined above. We must also set a rate that assures a high probability that we will be able to make our annual payment to the U.S. Treasury. There is an outstanding \$6.6 billion investment U.S. taxpayers

have made in the facilities that provide the Northwest with our low-cost hydropower system. Our region's ability to continue to reap the benefits of this system is contingent upon our paying off this debt on schedule.

BPA operates in an environment in which revenues fluctuate substantially due to water supply and market conditions, yet we must assure that we meet our obligations. For the past few months we have been exploring, in public processes, how best to manage risk recognizing that, as a non-profit agency, BPA does not have the option of cutting into a profit margin. We have heard clearly from our customers that they prefer that BPA rely more heavily on annual rate adjustments to compensate for risk, rather than BPA collecting money up front to put into a reserve fund. As a result, BPA has proposed structuring its rates with annual rate adjustments. This results in rates being lower than they otherwise would be, but it also means our customers will experience more rate changes. Adopting this approach makes it difficult to predict what our specific rate will be in 2007 because the rate will be significantly influenced by water and market conditions in 2006.

We continue to explore with our public utility customers additional means to keep our rates as low as possible while assuring we can adequately deal with risk. We are aggressively exploring some very intriguing ideas that have come from our public process that could result in reductions to our initial rate proposal.

Involving the region

Because discussions of our costs are really discussions that involve meeting our statutory public purposes, we have an obligation to engage the public about the challenging choices and trade-offs we face. What is one person's efficiency can be seen by another person as shifting costs into the future or failing to carry out the agency's statutory mission. For example, reductions in funding for hydro system operations and maintenance could reduce costs today, but such reductions are likely to

lead to more costly generator breakdowns in the future, thus increasing costs and risking reliable service. Reducing support for energy efficiency or renewable resource development could lead to higher costs for future ratepayers. Similarly, choosing to push some costs out into the future could mean that we are making our children pay for our consumption today.

We have worked hard to create an exemplary public process for considering the difficult trade-offs associated with keeping near-term rates as low as possible while addressing all of our statutory responsibilities. For example, we provided line item budgets and over 1,000 pages of material in public meetings earlier this year during a five-month public process known as the Power Function Review. The public meetings were structured to allow participants to go into substantial detail about the critical trade-off issues. The extensive public process identified key policy issues where there

might be differences in values that could lead stakeholders to different conclusions.

Below is a photo of the close-out materials from the Power Function Review showing the comprehensive information produced on BPA budgets and costs, along with policy issues identified in this public process and our conclusions, including follow-up issues. You can review these materials at the following Web site: www.bpa.gov/power/pll/review/06-24-2005_final_report.pdf.

We encourage you to review these materials as we will be revisiting many of these questions early next year in the follow-up public process to again review our costs. We remain open to and interested in new ideas. The cost review process, while separate from the rate case, will define the costs we will use for setting our final rates. Information and the dates regarding the follow-up process will be posted on our Power Business Line Web site at www.bpa.gov/power/review.



In 2005, BPA presented detailed budget information in accessible formats throughout the Power Function Review. Over five months, the agency conducted 13 meetings for utility managers and technical/financial staff as well as five meetings for the general public in Portland, Ore.; Seattle, Wash.; Spokane, Wash.; Idaho Falls, Idaho; and Missoula, Mont. The meetings were designed to engage the region on key policy issues.

We believe these extensive cost review processes are important steps forward in allowing the public to be informed and to provide input to the difficult trade-offs that must be made in setting rates.

Anticipating potential new costs

While we have been striving to reduce costs, there is one area of potential cost increases that remains a substantial risk. The federal agencies' plan for protecting threatened and endangered salmon has been successfully challenged in federal district court. The court is currently considering alternative federal hydro system operations for 2006 and beyond that could have substantial cost consequences. The types of operations under consideration by the court make this the single biggest cost risk area that could impact our rates for 2007 and beyond. We estimate that fish and wildlife restoration activities already represent approximately

30 percent of BPA's power rates. If you would like more information about this issue, please go to the Web site at www.salmonrecovery.gov.

Finally, we welcome your interest and involvement in our rate-setting process. We understand your desire for the lowest possible rate, and we will seek to accomplish that while meeting our responsibilities as a public agency. There are difficult choices to be made, and we particularly welcome your input on these public policy trade-offs that will impact our region's power system far into the future.

Sincerely,



Stephen J. Wright
Administrator