Bonneville Power Administration
Financial Policy Issues Workshop

February 25, 2003

BPA Rates Hearing Room, Portland, Oregon
Approximate Attendance: 100 present, 25 by phone

Opening Remarks

Steve Wright (BPA) welcomed participants and said the meeting was a unique event. I don't know that we've tried this before, meeting at the policy level to talk about the issues that confront us, he stated. After conferring with many general managers about how to conduct the meeting, Wright said he decided to start the session with information about BPA's financial situation and the available cash tools, "to get us all to the same place" for the discussion. I want this to be mainly a dialogue with you, he added.

BPA's Financial Picture

Paul Norman (BPA) went through a handout entitled "What Happened Since Financial Choices that Led to a Projected Net Revenue Loss of about $900 M for FY02-06." He started with Graph 1, which displayed why rates are so high in this five-year rate period relative to the previous rate period. The fundamental answer is that costs are about $5 billion higher, Norman said. We took on 3,300 MW of additional load service during the Subscription process, and $3.9 billion of the $5 billion is power we bought and the loads we bought down to meet that obligation, he explained. Norman outlined the remainder of the cost increases, from financial benefits for IOU residential customers to costs for terminated projects.

Graph 2 shows the net revenue side of the story, comparing now-expected costs and revenues to those included in the rate cases, he continued. According to the graph, BPA has not realized about $1.4 billion in expected revenues, primarily from secondary sales revenues, lower 4(h)(10)(c) fish-cost credits, lower than average hydro conditions in FY03, and the aftermath of the drought in FY02. In addition, BPA has bad debts of about $80 million it has been unable to collect from DSIs and from the California ISO/PX, Norman pointed out. The bottom line is, if we don't use the Safety Net Cost Recovery Adjustment Clause (SN CRAC), we're looking at a $920 million net revenue loss for the five-year rate period, he stated.

You started the rate period with several hundred million in reserves, **Denny Robinson (Cowlitz PUD)** pointed out. We started the period with about $600 million in reserves, and if nothing else were done, we'd come out of this rate period with a $300 million net revenue loss, Norman said. We also had $325 million in Fish Cost Contingency Fund credits, most of which we used in 2001, Wright explained. We assume we will use the remaining $79 million by the end of this year, given the current water conditions, he added.

Jim Curtis (BPA) explained the concepts BPA uses to manage cash and the tools available to assure the agency's liquidity. The financial situation means it is fairly likely BPA will use "cash tools" to get through the year, he indicated. Curtis explained BPA's net cash-flow profile, which shows the agency in negative territory during the summer and fall due to paying the Energy Northwest (ENW) budget. He also went over the cash tools BPA has already used in the rate period to shift about $550 million in costs out to the future. The estimated annual impact of the shifts is $50 million to $85 million annually from 2007 to 2011, Curtis said.

Curtis described the use of "debt optimization," which rolls forward some ENW bonds. We use the money to pay the U.S. Treasury, he said. It is essentially a "debt swap". Debt optimization will reduce BPA's total interest expense $20 million per year on average through 2018, and at its peak, by $40 million per year, Curtis said. He also explained the relationship between debt optimization and BPA's borrowing authority, indicating that without the ENW refinancings, BPA would run out of borrowing authority much sooner.

Curtis pointed out that BPA's Standard and Poors' AA- bond rating depends on several factors, including maintaining positive cash flow, rebuilding reserves, and setting rates so the probability of meeting Treasury will not fall below 88 percent. If our credit rating is downgraded, we won't be able to save as much in future interest costs, he said: "if the rating goes down, interest rates go up." He summed up the consequences for BPA's reserves, borrowing authority, overall costs, and rates if various cash tools are used and if various approaches are taken to resolve BPA's financial crisis.

Steve Loveland (Springfield) asked if PBL pays the bill for the $315 million in debt optimization that will go for TBL projects. Curtis explained that the money would go to prepay Treasury, which becomes the source for capital borrowing in the future. Given "your dire straits," you should not be funding capital projects, Loveland said. You need to find a way to keep the $315 million, he advised. Curtis responded that if BPA were to retain the funds, interest costs could be higher in the long run.

You are long in the market through this rate period, Loveland countered. You do not need to be investing in large capital projects so you can accommodate more power sales, he said. By deferring capital projects, you save both capital and interest costs, Loveland pointed out. One option is not to spend the money, get through this crisis, and then make the expenditures, he advised.

Chuck Dawsey (Benton REA) asked if staff has any doubt, given the variability in the numbers, that the SN CRAC has to trigger in 2003. This is a probabilistic analysis and the outcome covers a range of possibilities, but yes, we believe it is solid, Curtis indicated.

As I understand it, there are ways to avoid raising rates, but they all have consequences, and what we're doing is weighing the consequences of going with one course of action or another, **Jack Speer (Alcoa)** clarified. Yes, Wright responded.

Are the cash tools adequate for you to avoid deferring the Treasury payment? **Paul Murphy (Golden Northwest)** asked. In many circumstances, yes, Curtis replied.

Why is it better to use the $315 million to increase your borrowing authority, rather than apply it directly to a capital expenditure later on? **Rick Lovely (Grays Harbor PUD)** asked. Isn't one debt the same as another? he asked. If you don't prepay Treasury, but use the funds directly in this low interest rate environment, it could mean leaving higher interest rate bonds outstanding, thereby increasing overall interest costs, Curtis replied. Wright pointed out that BPA is making cuts to its capital program, but some projects need to proceed.

You are expecting to try to rebuild reserves, but a lot of us have had to re-evaluate that option and manage to our current situation, Lovely said, adding that it's not prudent for BPA to put a burden on ratepayers to rebuild reserves under today's financial conditions. He also questioned the extent to which a downgrade in S&P rating would affect BPA's interest rates. There are real financial consequences for a federal agency to have a rating at or below A, Curtis responded. It creates skepticism and can affect your access to capital, and can trigger negative consequences with trading partners, he stated.

Does ENW have to approve if BPA uses the refinancing revenues for other than paying Treasury? **Bill Drummond (Western Montana)** asked. **Margaret Allen (ENW Executive Board)** responded that the Executive Board votes whether to approve debt optimization each year. BPA can use the funds in other ways, but "we hope and expect" the proceeds will be used to pay down Federal debt, she indicated. We see the refinancing as a way to save interest, not add to debt, Allen added.

Curtis said there are others outside BPA who control how the agency structures debt, including the ENW executive board, bond rating companies, and insurance and surety providers. BPA has $50 million to $70 million of the refinancing proceeds in hand from prior years, but the bulk of the $315 million is expected from upcoming sales, he said.

Do you presume in any of your rate studies that there is an economic recovery and interest rates go back up? Lovely asked. You seem to assume you can continually refinance ENW bonds, he commented. We don't make that assumption, and we typically don't include refinancings in a rate case that aren't a done deal, Curtis indicated.

Valerie West (Senator Gordon Smith's staff) asked about the BPA cost increase labeled depreciation, amortization, and net interest. These are generally expenses for people who pay taxes, she pointed out. We use commercial accounting standards and track these things as expenses, Curtis replied. Almost the entire increase represents net interest, he added.

Wright asked for topics people would like to address in the remainder of the meeting. Participants suggested several topics: augmentation costs and load-reduction payments; the overall economy and potential for industries to cut back or close; customers' views on how BPA should deploy the cash tools it described; the relationship between the financial mechanisms and rate actions in future years; whether to deal with the out-years at this time; actual expense reductions; a general plan about resolving the situation; and general comment on BPA's finances.

Charley Hathaway (Georgia Pacific) asked about the 2003 water conditions and why BPA is forecasting 72 percent of normal runoff, while PowerEx forecasts 96 percent. Wright pointed out that runoff in British Columbia's Peace River system is quite different from that in the Columbia. NOAA has a web site that includes Northwest river forecast information, he added: http://www.nwrfc.noaa.gov/.

You left Congress out of the list of the players in your debt structure, according to **Fergus Pilon (Columbia River PUD)**. You have a February 19 letter from 17 members of the Congressional delegation asking you to do everything in your power not to trigger the SN CRAC due to the economic situation in the region, he pointed out. Pilon urged BPA to look at its options for "a political solution" and to explore whether the prepayments to Treasury offer some leverage toward that end.

Summary of General Comments

Don Brunell (Association of Washington Business): We are concerned about the proposed rate increase and the effect it will have on our members and their ability to produce jobs. Consider the impact of a rate increase on working families and industries. AWB conducts comparative studies of how energy costs in Washington compare with those in other states, and we've found that Washington is on the edge of cost-effectiveness compared with other areas of the country.

Don Sampson (Columbia River Inter-Tribal Fish Commission): We want to work with you to find a way out of this financial crisis. The work the tribes do for fish and wildlife restoration goes into rural economies; it is important to acknowledge there is an economic benefit of salmon recovery. In the past rate case, we were concerned that BPA was being too optimistic about its revenues and was keeping rates too low to cover all of its costs. In terms of BPA's costs, the fish and wildlife program is the only area where costs are at or under estimates. Other parts of the country are watching us to see if we are meeting our obligation to salmon restoration. If we are not, we face the possibility of "a God Squad" taking over restoration activities – the rest of the nation will face whether to keep Northwest rates below market or let salmon go extinct. We have already seen $41 million in cuts from the fish and wildlife program. Those cuts mean jobs for us. We are committed to working with you, but the fish and wildlife budget is not the problem.

Lanea Holt (Lost River REA): Lost River raised rates 44 percent last year, with a 33 percent increase to irrigation customers. Many of our residential customers are seniors and young families, and our businesses are "the Mom and Pop variety." Over the past year, we've seen the number of irrigated farms decrease. We have seen many dairies in neighboring counties file for bankruptcy, and we raise the hay in our valley that feeds those dairy cows. We have implemented cost cuts, from travel to eliminating jobs, and now we have to reconsider benefits. I would remind BPA of "the food chain": Your customers are your source, our customers are our source, and our customers have no source – they can't request additional funds. Look at all options to reduce or forestall the SN CRAC.

William Fleenor (Central Lincoln PUD): After all is said and done, will we ever see 22-mill power? Before 2000, we had costs that might have gotten us there, but now it seems we will never get there.

There is a wide range of what our rates could be post-2006, Wright responded. We have many policy questions to consider in that regard, and we are anxious to get back to the Regional Dialogue, where those discussions were taking place, he said. We want "to hit the ground running" on those issues when this rate case is over, Wright added.

Paul Davies (Central Lincoln PUD): The Toledo lumber mill is key to the economy of our area, and another rate increase could push them out of business. That would be devastating in a county that is already dealing with a troubled economy.

Rick Crinklaw (Lane Electric): How do we communicate with our customers about this SN CRAC? The material you are sending out is too complex to pass along to them. In 2001, we were facing a large increase, but with the expectation that the trend for rates in the future would be downward. We used your charts to explain this to our customers, and they are now asking when will their rates go down. Put your message in a format we can use at home, rather than send me this information and let me be the messenger. Customers need to get this message from you.

Chuck Dawsey (Benton REA): When I see BPA's circumstances, I don't understand why you are not refinancing to spread payments out rather than to make accelerated payments. In the rural areas, things are not bright and sunny like they are today here in Portland. People are not sympathetic to your situation. We implore you to take stock of what is going on in rural areas and what your increases are doing to us. Take whatever action you can to avoid another rate increase. (Dawsey then submitted a petition to Wright signed by Benton REA customers. This petition will be put in the public comment file.)

Clarence Harper (IAM Union): Our position is to oppose your intended 15 percent rate increase. We find your proposal unacceptable, as it will put manufacturing in the region at a disadvantage. We feel it would be shortsighted to raise rates without cost cutting. You must do what you can to ensure industry survives. Take a long, hard look at yourself and make the painful decisions. We don't believe BPA has explored or identified all ways to cut costs; only after you do, should you raise rates.

Daren Krag (Union Official): This is a contract year, and we know we will have to give things up. Our operation has gone from 1,100 to 700 people. The changes have meant more work with fewer people, and while people aren't happy, they know it's necessary to ensure we survive. You are trying to get your administrative costs to 2001 levels, but "we'd love to be there." You have to make tough calls. If we don't get past this, our operation isn't going to be here. Think about the viability of industry before you raise rates.

Hugh Diehl (Alcoa Intalco): We have been told if rates go up 15 percent, our plant will close. When you make this decision, think about us.

Dave Faddis (Kimberly-Clark): We've seen our power rates go up 100 percent since 2001 at our plant in Everett. That is $12 million a year in additional expenses, a "catastrophic event" for our costs. We have had to make hard decisions about our operation. The "head count" is down 10 to 15 percent, and "we've turned down every other cost-control knob." Our customers have a choice of suppliers, and our future depends on our ability to stay competitive. What are you going to do with your structure to regain your position as a low-cost energy provider in the United States? We've seen our relative position in terms of energy costs among other Kimberly-Clark plants go from the bottom 25 percent to fourth from the top. What are you doing to compare yourself to others that are doing this cheaper? How do you compare with the performance cost of others? What controls are in place for oversight of decisionmaking? You need to take the stakeholder perspective into account.

Steve LaFond (Boeing Co.): Our power rates are also about 100 percent higher than they were in 2000. When we think about where to sight new facilities, that's a factor, and we can't afford to endure these continuing rate increases. I appreciate that you have cut the rate of your internal cost increases, but you need to cut to pre-2001 levels.

Kris Mikkelsen (Inland P&L): We advise you not to defer costs into the future; it will only defer the hard decisions needed to reduce costs. The SN CRAC should be used if the Treasury payment will be or has been missed. The focus should be on the current year, not on future years, since conditions can change. Use financial tools to reach the standard for avoiding the SN CRAC in 2003 and defer the SN CRAC to mid 2004, if it has to be triggered. The financial tools should not be used in lieu of opportunities for cost reductions. The level of benefits to the IOUs has got to be resolved for the remainder of the rate period in a way that is equitable and consistent with the Northwest Power Act. We support the efforts of NRU.

Valerie West: The numbers you presented are not the total picture. They are the differences in your costs, but not a summary of all costs, which I would like to see. Don't consider "any pot of money" too small to consider in your cuts. Will you continue to use the voluntary separation incentive to reduce staff?

We used the incentive that was specific to BPA until it expired December 31, 2002, and 80 people left, Wright replied. Another tool is available, but it is not as easy to use, he added. Should we work to extend the voluntary incentive? West asked. We'll wait to see where we stand later in the year, Wright responded.

West asked about California's outstanding debt with BPA. Wright said the total for the DSIs and California is $80 million, and legal cases and bankruptcies stand in the way of BPA recovering the money. "We are pursuing that vigorously," he added.

Russell Greene (West Oregon Electric): We have taken extraordinary steps to reduce our budget. In 2002, our budget revenues were less than in 2001, and we had no budget increase in 2003. We watch every penny and have reduced staffing, but in the next few months, we will be paying over a million dollars more in power costs than we were two years ago. Take the same extraordinary steps we have to reduce costs.

Bob Wittenberg (Skamania PUD): The wholesale G&T co-op I dealt with in Colorado in the 1980s is no longer in business. They had some costs they couldn't avoid, but they also didn't appreciate price elasticity. Your rate increase will not bring you the revenues you expect because "the well has run dry." Cut where you can't imagine cutting – go below 2001 levels. We've dropped organizational memberships and are driving old vehicles. Go after the system augmentation costs – there are ways to get there.

Allen Sanders (Ponderay Newsprint): Our mill is 30 percent of the tax base in Pend Oreille County and accounts for hundreds of direct and indirect jobs. I worked for a similar plant in the southeastern United States, and TVA's power rates were 50 percent lower than BPA's. Load management was an important part of our relationship with TVA. We urge BPA to look at real, not just relative, cost reductions. We've severely limited capital outlays and are taking risks we feel are appropriate, given the current economic conditions.

Pat Flaherty (Alcoa Intalco): What this 15 percent increase means is our plant will shut down. If we lose all of these jobs, it will mean a lot for the future of Oregon and Washington.

Pamela Lesh (PGE): We helped arrange for deferral of some of BPA's obligations, but it was in the context of what is going to happen in the future. We hope we can continue to talk about the future and not just solve this problem for today.

Dirk Borges (Canby): In a recent customer survey, our utility fared poorly with customers, despite large gains in reliability and outage reductions. We are down from an average of 18 hours of outage annually to 10 minutes, yet our standing with residential and commercial customers dropped substantially since 1998, particularly in the area of keeping costs in line. If we don't get this worked out, our long-term relationships with our customers will suffer. What our survey told us is that customer service can't overcome the impact of large rate increases. If you can defer some of this increase or find a way to make it more palatable, please do so.

Roberta Weller (Ferry PUD): Ferry's five large industrial customers are either gone, going, or just hanging on. We can't take any more increases; we've taken all the hits we can take.

Rick Lovely: We believe we are at a point of desperation in Grays Harbor County, and the situation calls for desperate measures. Our O&M budget is $2.3 million under what it was in 2000, and we have cut staff, costs, and capital, and borrowed money. Look for ways to get your costs below 2001 levels. Steve, "you have inherited a mess," we recognize that. Take the opportunity you have to work at change in the culture – "business as usual can't continue." You need to marginalize capital expenditures and reserves, as we have done.

John Gerstenberger (Hood River Electric Cooperative): A couple of winters ago, BPA asked our utility and others to reduce load 10 percent. How did we do it? Our sawmill closed, and it was 10 percent of our load. In addition, we had another 4 to 5 percent drop in load because of the 2001 rate increase. We now have an opportunity to site a glass manufacturing plant in our service area, which could add jobs and load. But the SN CRAC could jeopardize our ability to attract that facility. It could reduce our loads further and chase away new load. Our fruit industry is also struggling in the world economy, and further expense will only make the problem worse. We urge you to reduce or eliminate the SN CRAC.

Pat Reiten (PNGC Power): We hope BPA will look at its entire cost structure, regardless of how those costs flow back, and address all factors in costs that show up in retail rates. Don't lose sight of your long-term situation. System augmentation costs are a major source of price instability for BPA, and the planning for your post-2006 obligations is an important consideration. Until it is resolved, it hampers our ability to look at our power supply options. If we have to delay that process, let's use the time to look at the underlying issues and continue to make progress on them.

Jack Speer: BPA is talking about an increase that would take $1 billion out of the Northwest economy. We have shown there are ways to avoid doing this. We have to find a way to put this billion dollars back in the pockets of people in the Northwest instead of in BPA's bank account. This is about giving BPA future borrowing authority – do we keep the money in Northwest ratepayer pockets now or put it towards BPA's future borrowing?

Bob Crump (Kootenai Electric): Don't swing too far toward the short-term and forget about the long term. Looking at the cash controls you are considering "scares me," and implementing them could cause more problems in the future. You are talking about pushing costs past 2006, and that's a concern. Don't do things that will compound the risk down the road. If you push costs out into the future, when will the situation change? Is the SN CRAC really justified? There are good arguments for delaying it and looking at other things we can do. We need to talk about what specifically we can do, and NRU has some good comments to offer on that.

Dick Tyler (Weyerhaeuser): We are in the commodity business, and we can't easily pass along cost increases in our product prices. Our plant in the Southeast pays 28 mills, but there is no one in this region who can match that today. "We are out of whack with the rest of the country." We used to have an advantage with energy prices, but no more. We have to go back and see what we can do to get competitive again in this region.

Ed Hansen (Snohomish PUD): Our rate of disconnects is at an all-time high. We can't ignore that there are lots of citizens struggling to pay their bills. There are unusual times in our economy, and we are at a point where economic circumstances should be a major factor in evaluating the choices here. There have to be tools that can be used so no SN CRAC is required.

Charley Hathaway: It's no secret we situated our plants in the Northwest because of the availability and low cost of power; but now, we are no longer competitive with plants elsewhere in the country. You are talking about a 15 percent increase on top of a nearly 50 percent increase in October of 2001. There has been a lot of discussion about costs, but I didn't see an income statement.

A Customer-Proposed Alternative

I suggest you look seriously at alternative paths to get from here to the future, **John Saven (NRU)** said. We said last August that you should focus on the 2003 problem and deal with FY 2004-06 on a case-by-case basis, and we suggested you cut costs, avoid doing things that impair your ability to use financial tools to mitigate rates, and not to impose an SN CRAC, he stated.

Saven pointed out that the SN CRAC trigger case hinges on about $40 million. He contended that with proposed cost reductions, BPA is within striking distance of meeting the 50 percent Treasury payment probability required in order not to trigger the SN CRAC. Consider whether there is anything that could be done to eliminate the SN CRAC, Saven urged.

Our proposal is to use a portion of the ENW refinancing savings as a reserve to be drawn upon as necessary to make the FY 2003 and 2004 Treasury payment, he stated. Saven acknowledged BPA might start 2004 with only $82 million in reserves, but under the circumstances, he viewed it as prudent.

I'm not advancing a figure about the level of ENW refinancing proceeds to put aside, but we are prepared to engage in that discussion, he said. We don't think using a limited amount of those reserves would have a deleterious impact on BPA's standing in the financial community, and if it delays some capital investments, we think it's a risk worth taking, Saven said.

You have to give full consideration to alternative paths, and using a limited portion of the ENW proceeds gives you "a mathematical solution," he said. We would stand by the agency in deferring the SN CRAC proceeding; we could meet again in October 2003, and if the SN CRAC had to trigger, it could happen in mid 2004, Saven suggested. I want to be clear that I am not talking about the entire $315 million, but “a capped portion of it” to be used only if needed to meet the Treasury payment, he added.

A lot of people think this is a good idea, but not everyone does, Wright responded. I haven’t had a chance to debate the points with opponents, but given the other options, this seems like one that offers many positive attributes, Saven indicated.

If this solution required BPA to use all of the $315 million or more this year to assure liquidity, would you feel the same? Curtis asked. I haven’t proposed using all of the proceeds, but I would have to see the numbers to answer that, Saven responded.

<u>Others React</u>

We’ve come to the conclusion BPA cannot cost-cut its way out of this, **Steve Weiss (NWEC)** stated. We agree you can’t raise rates much either, he said. The only alternative left is borrowing the money, Weiss said. This type of proposal was also offered by NWEC – we proposed filling the revenue gap with one-third cost cuts, a small rate increase, plus some borrowing, and looking at the situation year-to-year, hoping things get better, he said. We would tend to support John’s proposal, Weiss stated. You can’t cut programs that will be needed in the future and you can’t raise rates much more, he added.

I think my clients would support this, **Terry Mundorf (WPAG)** said. Deferring the SN CRAC gives us an opportunity, outside of an adversarial rate case proceeding, to explore ways to bring costs and revenues into balance, he said. Another advantage is taking things one year at a time, Mundorf stated. About $500 million of the $900 million gap is due to an expectation about the market and non-firm revenues, he said. The market may present us with the $500 million problem, but it may not, Mundorf said. Let’s make a decision when we are “more proximate” to the problem, he recommended.

Reiten said he thought the proposal was supportable, with two caveats. First, if you borrow, only borrow amounts as necessary and as limited as possible; and second, BPA continues to pursue a course to reduce the Slice true-up and LB CRAC and further address its internal costs, he stated.

I see two issues here, Murphy stated. The first is long-term policy on how BPA should structure its business to best cope with the future, and the second is adherence to the rates adopted in 2001, he said. It was a major acquiescence from customers to face the CRACs, and they were willing to accept them with the understanding CRACs would only be used in the worst case, Murphy said. BPA has determined that with identified cost cuts, there is a 36 percent probability of being able to pay Treasury, he continued. But BPA is assuming it will take all of the cash available from ENW refinancings and prepay the Treasury, Murphy pointed out. If you accounted for the $76 million of those proceeds already in hand, your Treasury payment probability would exceed 50 percent, he said. I understand that you are trying to save overall interest costs, but that isn’t a big effect, and a rate increase at this time will certainly have “big and deleterious effects,” Murphy said. You don’t meet the test you set in the rate schedule provisions – the trigger has not occurred this year, Murphy concluded.

Wright said he could not overlook the $900 million projected net revenue gap and the reduced estimate in secondary revenues. This issue is also about where are we going, and the problem could be even bigger next year – we can’t ignore it, he stated.

We are not ignoring the problem, but trying to show ways you could avoid the SN CRAC, Dawsey stated. You are talking about an increase for the next three years, when you could wait until the picture is clearer, he said.

I’d join in support for “the three-point plan,” **Alan Zelenka (Emerald PUD)** stated: cut costs back to the 2001 level, take the $315 million and put it in reserve to use if needed; and take things one year at a time. Hopefully, doing these things will allow us to forego an SN CRAC this year, he said.

We are willing to consider this, but it is pushing the debt forward, Allen stated. We have to think about whether it is good policy to have the ratepayers of 2013 and 2018 pay for this, she said. We have to be clear that is what we would be doing, Allen said.

It’s extremely important we take this a year at a time, Lovely stated. The region is on the border of a recession and “if you pull this SN trigger for three years,” you will miss your Treasury payment now, you will miss future payments, and we will be looking down the barrel of much more serious issues, he cautioned.

I don’t mind looking at this as a one-year problem, but it is a $900 million problem over the next three years, Loveland pointed out. We could be back here next year with a bigger problem, and we need a plan that gets us out of the woods for the long term, he stated.

Our customers understood the LB CRAC numbers would come down over time, but your graph shows the SN CRAC getting higher, and the LB CRAC isn’t diminishing very much over the rate period, Dawsey said. Our customers expected these rates to start coming down, he said. “It’s a financial problem, but it’s also a political problem,” Dawsey stated.

We said we expect the combination of the SN, LB, and FB CRACs for 2004-06 would be 15 percent above this year’s rates, Norman said. In response to a question about reducing its estimates for secondary revenue, Norman said BPA is using the best forecasts of hydrosystem output and not attempting to build any additional financial reserves into the estimates.

I see a death spiral if you impose the SN CRAC, Fleenor said. Is there any thinking about keeping rates down to stimulate the economy and “to keep this plane from crashing?” he asked.

We'll talk more to John about the proposal, but we aren't prepared to respond to it now, Wright stated. We still have big concerns about the SN CRAC and needing to implement it October 1, and I don't see us stepping off the SN CRAC soon, he acknowledged. But we will engage on the proposal to see if we can adopt it, and if not, we'll tell you why, Wright stated.

What happens when we get closer to the end of the fiscal year? Is there enough cash in the tools to cover the Treasury payment in 2003? **Rob Lothrop (CRITFC)** asked. We ran the analysis, Murphy responded, and if ENW completes the planned refinancings, there isn't a single scenario in a set of 3,000 probabilities in which BPA could not make its full Treasury payment. The worst scenario has BPA making the full payment and keeping $70 million, he added. One thing I would stress is that this proposal isn't pushing the problem off, Murphy stated. The customers are saying use the cash tools to give you the time to make meaningful cost cuts, he said. There isn't a problem in 2003, it is in the future years, Murphy stated.

I'm worried that this is "unrebutted rate case testimony," Curtis responded. We need $200 million in liquidity to get through the spring, summer, and fall, he said. Your numbers don't work for me, Paul, Curtis stated. I worry about people leaving here with the wrong impression about the feasibility of what you are suggesting, he added.

I'm just saying by substituting our proposal, we will meet BPA's criteria for purposes of the trigger case, which is 50 percent or higher probability of making the Treasury payment, Saven responded. Steve, we're asking you to consider alternative paths as opposed to having one path; but at the end of the day, "you make the decision," he added.

And we are willing to listen and look at the advantages and disadvantages of an approach like this, Wright stated.

Why should our ratepayers have to pay for the DSI bad debts, Hansen asked. Is there a way for the Treasury to pick up the tab for the debts incurred because of federal policy in the California crisis? he inquired. We're a not-for-profit, and there is nowhere else for the DSI costs to go, Wright responded, adding that the statutes require BPA to recover costs. It has not been our view that the California situation was tied to a specific federal policy, he said. We made sales to California consistent with the way we've made sales to California since the Interties, and we're doing everything we can to get paid, Wright added.

Steve Oliver (BPA) reported that $8 million of the $80 million total bad debt resulted from BPA making sales to California under order from the Department of Energy and that none of those sales is part of the lawsuit in which California is disputing the price of the energy.

I've heard that we have financial tools to get us through this year, **Loren Baker (PRM)** stated. In the long term, BPA probably needs fundamental reform, he said. For 25 years, customers and stakeholders have been putting huge demands on BPA, and you've tried to meet them all, Baker continued. But the reality is, you can no longer meet them all, he said. The problem with IOU benefits is the result of conditions that existed prior to the 1980 Northwest Power Act; but the fact is, the situation "has flopped around the other way," and we need a renegotiation of those benefits, Baker commented. He also said BPA's fish and wildlife program needs re-evaluation and assurance that the measures being funded are based on science. As customers, we need to be working much closer with you, Baker added. I see us needing a two-pronged approach that runs in parallel, he concluded: the details to get through 2003 and a longer-term policy discussion, as well.

One of my biggest concerns with the proposal John put forward is the $900 million we're looking at in the future, Wright said. It feels like we're pushing the problem forward, he said. As one who negotiated with BPA staff on the CRACs, I have a different view of what the SN CRAC was supposed to be, Saven stated. I viewed it as a way to look at mitigation year to year, he said.

My clients are interested in this year and next year and getting there without losing the agency or the economy of the region, Mundorf stated. I'm focused on the near term, he said. Any proposal has to look at more than this year or next, but it's different than saying we have to pay for more than this year or next, Mundorf added. Cost cuts are a big part of it, and part of John's proposal is the opportunity to move some of the numbers out of the cost column, he indicated. Mundorf described the path forward as: you have received a proposal; we can elucidate parts of it if you need that; and then we need a response as soon as possible. As Jim indicated, there are players other than those of us here, he said, adding that the ENW board has to be part of the discussion, as well as the rating agencies. We need your reaction sooner, rather than later, Mundorf stated.

We have the question of whether to borrow money so we don't trigger the SN CRAC, which is being debated in the rate case; but that is different than the net revenue problem in 2004-06, Curtis clarified. It's not clear how to have discussions about the multiyear situation, since that will also be an issue in the rate case, he said. We need to preserve the integrity of the rate case, Curtis added. Your lawyer can advise us about that, but it's really just a matter of giving proper notice, Mundorf responded.

There have been lots of comments about our internal costs, Wright said. We have about $150 million a year in internal costs, and we have committed to keep those costs flat at 2001 levels, even though we are serving 3,000 MW of additional load, he said. If people are thinking we can use the ENW refinancing revenues plus more internal cost cuts "there is not $900 million there," Wright pointed out.

Hansen asked if river operations and changes to spill would add to hydro revenues. We've made good progress on that, Wright responded. We have $80 million in additional revenues in the fish and wildlife arena due to modifications in the river system, he said. "We're betting on the removable spillway weirs," and we're looking at some other potential changes in hydro operations, Wright added. I don't know how those discussions will come out, because we are starting out from a position of "does it work from a biological perspective." He pointed out that the Council came up with spending cuts for the direct fish and wildlife program that will keep it at $139 million in 2003.

We're in complete support of the proposal John Saven articulated, **Scott Brattebo (PacifiCorp)** stated. When BPA started having financial problems six months ago, the IOUs came forward with a proposal to defer $55 million a year – or $220 million total – for the remainder of the rate period, as long as good progress was being made toward the settlement of BPA's role in the region, he said. BPA declined the offer and replaced it with another proposal that has been negotiated, agreed to, and hopefully implemented, Brattebo explained. We are making a $55 million deferral in 2003 "with no strings attached," and we are ready to go to the PUCs for additional deferrals, Brattebo said. There is a $200 million item on the expense charts that relates to a settlement with Puget Power and PacifiCorp, he continued. Our ratepayers were entitled to those funds beginning a year ago, but BPA asked us to defer those payments, and we did, Brattebo said. We have also offered to forego them altogether, if we have a long-term settlement acceptable to the IOUs, he said. We need to focus today on getting through the short term, but there's potential for a $365 million reduction in expenses related to IOU benefits, which we are willing to work toward, Brattebo indicated.

We appreciate that, Wright stated. The $200 million is a big piece of this puzzle, and that's why we're showing it on our charts, he said.

Loveland pointed out that the IOU benefits mushroomed with Subscription. A previous Administrator over-committed the federal base system, we had to go to the market and augment the system to serve that, and then in 2001, BPA went to the same customers and bought down the contracts to reduce load, he said. I see $4.3 billion over five years in additional costs, and you are now turning to the PF customers to make up the shortfall – the public utilities are being asked to come up with a large payment, a transfer to other utilities in the region, Loveland stated.

The lion's share of the rate pressure is what you pointed out, Norman acknowledged. We have the opportunity to work that number down, he said. I don't see getting there at all without putting this on the table, Loveland said. The rest of your cost increases pale in comparison to the increase in IOU benefits and the buy-downs, he added.

We can't afford your 15 percent increase, Krag reiterated. If industry goes away, your problems will get worse, he said. Everyone in this room has said, we can't do this – we can't absorb this, Krag stated.

I have heard that message clearly, Wright responded. But we have a large revenue gap, and we also have to retain this system for the long run, he stated. We've paid the full cost of the Alcoa workers for two years, Wright added. The issue is how we set this up for the long run – the easy part would be "to kick it forward," but as we go forward, "we have to have a plan to get out of this hole we are in," he stated.

I have heard consensus on the NRU plan, Dawsey stated. Just because the Benton REA members “still have money to buy groceries,” doesn’t mean we should raise rates, he said.

I hear you and hope you have heard me. I have a fiduciary responsibility to be a good steward of this system, Wright responded.

We have taken on debt, and we are going through what you are going through, Dawsey said. When you bill us, you get 140 payments; but when we bill, we don’t get all the payments, he stated. Our money comes from ratepayers, and “they are at their limit,” Dawsey said.

I don’t think levelizing the payments to the IOUs through 2011 gets to the underlying problem, Mikkelsen stated. The absolute level of the benefits was too high to start with, she said.

Ed McKerlie (Alcoa Union) said the smelters have lost thousands of jobs in recent years and another rate increase could ruin the economy. Lower your costs and get things going again – then you’ll get some revenue in, he stated.

A big message here is price elasticity and impacts on the economy, Wright responded.

We have the same fiduciary responsibility to our utilities, and we are dealing now with survival, Lovely said. Maybe we need to consider some things that have never been tried before, he said. Lovely urged BPA to consider the approach Saven offered. Flesh out the opportunities that may allow us as a region to survive – get all of the ideas out of the box and get them on the table, he said. Energy prices have gotten so high, so fast in the Northwest, and there are so many pressures now that we are just trying to survive, Lovely reiterated. This is a different situation than we have ever had to face before, and we all need to try to make this work, he stated.

West said she is concerned about the consequences in Congress if BPA’s problems aren’t solved within the region. I’d encourage a regional solution – one in which BPA makes its Treasury payment – so the delegation can say the Northwest Power Act is working, she said. You don’t want “a blowup in the region” at the same time an energy bill is being marked up in Congress, West advised. We will be marking up a bill in the first two weeks of April, and if BPA doesn’t have a game plan by then, “it’s a problem,” she stated.

The region needs to have a regional solution, according to **Angela Becker-Dippmann (Senator Maria Cantwell’s staff)**. If there is not a regional solution, “it undercuts our hand in Washington, D.C.,” she said. The delegation is very aware of the region’s economic pain, but we need to have a plan that meets the short-term pain and long-term economic health, Becker-Dippman stated.

One of the frustrations is that we don't have a lot of control and are suffering with decisions that were made in the past, Faddis commented. We need to take a look at how the decisions were made that are causing problems now, so we don't do it again, he advised. It's very important to have some level of oversight of decisions that takes into account the customers and stakeholders, Faddis continued. If there had been oversight in place in past years, I can't help but think we wouldn't be here with all of these problems today, he said, adding that Kimberly-Clark could lend its business expertise to any cost-control proposals.

Management at BPA has always been acutely sensitive to the needs of the utilities it serves, Margaret Allen said. We want to thank BPA for applying the debt optimization proceeds to the Treasury payment back in September under difficult circumstances, she added.

We made a decision to try to shield the ratepayers from the energy crisis, Weiss said. BPA and others made long deals to shield ratepayers from an increase, and it has made a serious short-term problem into a long-term problem, he stated. If we are going to take a lesson from the past, let's take it now, Weiss recommended. If we don't take the pain now, we could again create a long-term problem, he stated.

One difference between the situation a couple of years ago and now is that prices are not too high, they're too low, **Kevin O'Meara (PPC)** pointed out. If BPA raises rates now, it loses load and exacerbates its revenue problem, he stated.

Norman noted that additional information on BPA's cost structure was being handed out in response to questions earlier in the meeting, and that the information would be posted on the BPA web site. And the federal budget is on our web site, Curtis added (http://www.bpa.gov/corporate/dff/conbud/index.htm). Oliver said he would provide more information on secondary revenues and briefings on BPA's system augmentation costs if people request it.

Dippman-Becker asked if BPA does elasticity studies, and Norman said they are a routine part of BPA's financial forecasts. There are two kinds of elasticity in question here, regional elasticity and BPA elasticity, **Linc Wolverton (ICNU)** pointed out. BPA has less of a problem because it has take-or-pay contracts, he said.

I want an opportunity to talk to you about this, before you decide to go this way or that, Saven said. The path forward is for me to understand your proposal, and we'll have another discussion, Wright said, adding that he will consider another meeting.

Meetings like this are beneficial, Mundorf said. It is better to have these discussions in a forum like this than in a rate case, and "the more we do this, the more we'll have success," he added.

Adjournment: 4:20 p.m.