Department of Energy

Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208-3621

EXECUTIVE OFFICE

September 16, 2004

In reply refer to: PFR-6

To our customers and Northwest citizens:

After much reflection on BPA's financial picture and careful consideration of input from our customers and stakeholders, I have made the decision to set the power Safety Net Cost Recovery Adjustment Clause for fiscal year 2005 at zero. This decision – combined with the $200 million reduction in the Load-Based CRAC announced in June – will result in a BPA power rate for FY 2005 that is 7.5 percent lower than the FY 2004 rate. The actual impacts will vary from utility to utility depending on the amount of power a utility buys from BPA, the nature of the power product purchased and the specific terms in the power sales contract. However, all customers should benefit from the fact that BPA is reducing its costs.

Although this decision to reduce rates is not without risks, I believe it is in the best interest of the region. A wholesale power rate decrease at this time should help fuel the Northwest's slowly recovering economy. By setting the Safety Net CRAC to zero, $123 million will remain in the Northwest economy. Our customers, industries and individual ratepayers have all made it clear that they need a rate decrease. It is also important that we repay taxpayers for their investment in our federal hydro system, and this decision preserves the integrity of the standard we have set for repaying the U.S. Treasury.

I am especially heartened that BPA was able to achieve this rate decrease for the coming year despite a number of challenging conditions in the current year. These included the fifth below-average water year in a row and secondary power sales revenues that fell $150 million below initial projections.

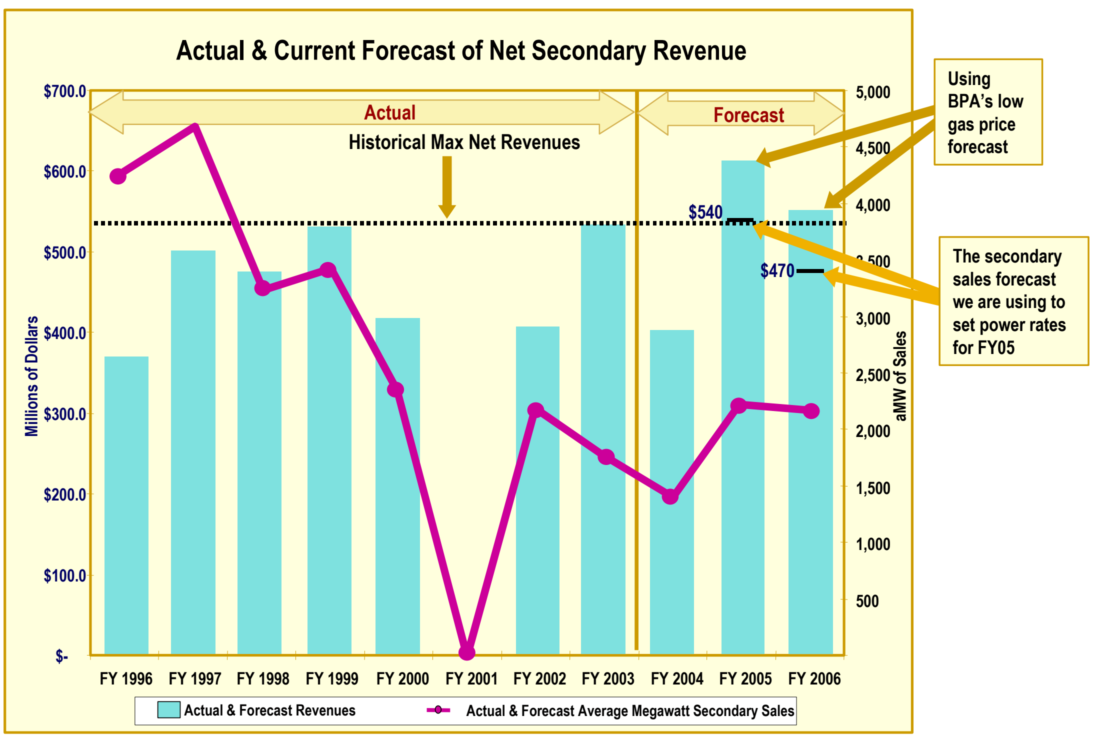
Given these financial impacts, I could not have made the decision to reduce power rates based on the year's financial performance alone. Fortunately, there were other factors that made the reduction possible. One was the intense and focused cost-cutting effort by our own employees as well as the efforts of our cost partners – the U.S. Army Corps of Engineers, Bureau of Reclamation, Energy Northwest and the Northwest Power and Conservation Council. I am immensely proud of how our employees and our partners met the challenge to reduce costs. I hope we have put to rest concerns that we would not pay attention to costs with a Safety Net CRAC in place.

A second factor was the collaborative assistance we received from our customers and constituents, especially through the Power Net Revenue Improvement Sounding Board. Their work helped us identify and secure additional cost savings and revenue enhancements. All of us at BPA are very grateful for the time and effort of these regional representatives.

In FY 2004, we captured $70 million in cost reductions over and above what we expected when we set rates in August 2003. For FY 2005-06, we are forecasting an additional $350 million in cost savings relative to when we set rates in August 2003. Well over half of this amount was secured through last June's agreements with the region's investor-owned utilities.

The region can be assured that BPA will continue to pursue further cost reductions. For example, we currently are initiating efficiency improvements in areas identified by the consultant KEMA as well as continuing our efforts to reduce interest costs through our debt optimization program. We remain committed to meeting or beating the cost targets we established in the Safety Net CRAC decision.

The final factor in the decision to reduce rates is the fact that we are forecasting robust secondary revenues for next year. As I said earlier, the decision to zero out the Safety Net CRAC does not come without risks. Secondary revenues – our income from surplus sales – pose the area of greatest risk. We are forecasting $540 million in net secondary revenues for FY 2005, a number that is both conservative and optimistic. It appears conservative when compared to current forecasts of natural gas prices. But it is optimistic in that, if we are to hit this forecast target, we must achieve the highest secondary revenues in our history.

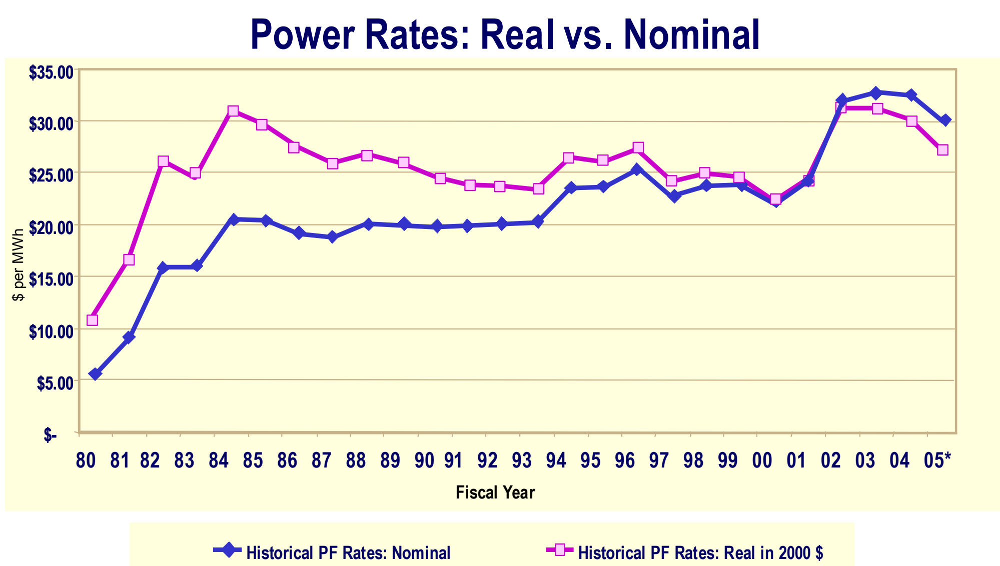


Given how volatile secondary revenues are – and the fact that they make up about a fifth of our revenues – we believe we have achieved a prudent balance between a conservative and optimistic outlook. And, given the need to help economic recovery now, I believe the decision is responsible. Still, it is important that the risks are understood. At a rates workshop this past August, we explained that a 7.5 percent rate reduction carried with it a 43 percent chance that rates would rise in FY 2006 and a 30 percent chance that the increase would be more than 8 percent. If, for example, we were to have a year similar to FY 2004 and were to realize only $400 million in secondary revenues next year due to low water or a collapse in prices for surplus power, we could face a rate increase of nearly 13 percent in FY 2006 – if everything else remained equal.

Conversely, there also is a chance that, if our revenue projections are realized or exceeded and we continue to be successful in our cost management, rates could go down again in FY 2006. There is an equivalent 30 percent chance that rates could go down 8 percent in 2006. It comes down to a little less than a 50 percent chance that rates will go up in FY 2006 and a little more than a 50 percent chance that they will go down. These estimates are based on maintaining our cost control and hitting our cost targets, which we intend to do.

In our efforts to reduce rates, we have generally resisted proposals that increase future rate pressure, but there have been exceptions. This year's agreements with the investor-owned utilities, for example, moved $100 million from this rate period into the next. If we are to achieve long-term rate stability, we need to avoid taking additional risk with respect to our future rates. I am committed to avoiding further actions that would increase future rates.

I am very pleased that the combined efforts of customers, constituents, partners and our employees are paying off. I have included a graph showing where this decision puts our 2005 rates on the long-term trend line in both nominal and real dollars. Looking forward, our challenge is to do everything possible to manage our rates and costs for FY 2006 while increasing our focus on the longer term to manage rates and costs in 2007 and beyond.



* FY05 power rate level represents a 7.5 percent rate reduction (no SN CRAC)

Finally, I believe we could not have achieved the current decrease without tremendous cooperation from a number of people working toward the same goal, and I am deeply grateful for this help. I hope that this decision will help us unite as a region so we can focus on the long-term issues that can make a positive difference for our region.

Sincerely,

/s/

Stephen J. Wright
Administrator and Chief Executive Officer