Department of Energy

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

POWER BUSINESS LINE

April 1, 2005

In reply refer to: P-6

Dear Customers, Constituents, Tribes, and Other Stakeholders:

This letter accompanies the presentation materials for the Power Function Review Technical Workshop on April 6, 2005, which is the first workshop to deal with the important issues regarding the alternatives for handling risk mitigation in 2007 power rates.

Increased business climate volatility and six years of drought have significantly changed the landscape of risk and uncertainty facing BPA and its stakeholders. These present new challenges for BPA to keep its power rates as low as possible while meeting its obligations to the U.S. Treasury.

- Most significantly, PBL rate period starting cash reserves are projected to be much lower (approximately $180 million) than in the 2002 rate case.
- Market prices for secondary energy are much more volatile than the last time PBL set rates in 2002.
- Certain mitigation tools are no longer available, specifically the $325 million that was available in the Fish Cost Contingency Fund.
- We believe that BPA needs to return to its traditional Treasury Payment Probability (TPP) standard of 95% for a 2-year rate period (92.6% for a 3-year period). Current rates are meeting a lower 80% 3-year standard.
- We are planning to increase minimum liquidity reserves (formerly known as working capital) from $50 million to $100 million.
- Some new risks have appeared on the landscape that either did not exist in 2002 or were not modeled, namely uncertainty in IOU benefits, wind generation, and transmission expenses.

These changes create greater risk for BPA, reduce our ability to absorb those risks, and/or increase the costs of managing them. If rates are designed in their usual manner as a flat 3-year rate, these changes mean that power rates would need to recover a much larger “risk premium” than ever before in order to meet the TPP standard. This risk premium is referred to as Planned Net Revenues for Risk (PNRR). I believe that this traditional approach results in far too high a rate.

Therefore, at the workshop on April 6, we plan to begin a dialogue with customers and other stakeholders to search for alternative and less expensive ways to manage risk in the FY 2007-2009 power rates. BPA staff has identified several rate design alternatives that reduce PNRR and that have various impacts on rate levels, rate volatility, and cash reserves. We expect and encourage many other ways of managing these risks to be advanced and discussed, and look forward to a robust regional discussion of this crucial issue.

Sincerely,

/s/ Paul E. Norman

Paul E. Norman
Senior Vice President