Department of Energy

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

POWER BUSINESS LINE

April 16, 2004

In reply refer to: PL-6

Dear Customers, Constituents, Tribes, and Others:

The Bonneville Power Administration (BPA) continues to be very concerned about the impact of its electricity rates on the economy and ratepayers of the Pacific Northwest. We are working diligently to further reduce costs and enhance revenues to keep rates as low as possible. BPA is seeking comments between now and May 14, 2004 on a proposal that would result in a cost reduction of $200 million for fiscal year (FY) 2005 and FY 2006.

Background

Over the past 6 months BPA has focused on three main ways to reduce costs and enhance revenues that could reduce rates for FY 2005 and FY 2006. First, the Power Net Revenue Improvement Sounding Board is focusing on identifying at least $100 million in net revenue improvements in FY 2004 and FY 2005. Information about this group and its progress can be found on BPA's web site at www.bpa.gov/power/pl/pnrisb. Second, on March 30, BPA and the Corps of Engineers issued a preliminary proposal for reduction of summer spill combined with offset measures that could reduce the cost of spill and improve power revenues. The goal is to achieve similar or better biological benefits at lower cost. Information on this proposal and future decisions can be found at www.salmonrecovery.gov. The third area is the subject of this letter. It is a proposal that grew from discussions among BPA, public power, and the investor-owned utilities.

Puget Sound Energy, Inc. (Puget) and PacifiCorp have until early June to request payment of the $200 million reduction-of-risk discount that was established in their load buy-down agreements and that is owed to their residential and small farm customers. This payment was the focus of the recent unsuccessful attempt to settle litigation filed by public utilities regarding the level of benefits going to the residential and small farm customers of the region's investor-owned utilities. Since then, BPA, PacifiCorp and Puget have agreed on terms that would reduce BPA's near-term costs without requiring public utilities to dismiss their litigation.

The Proposal

The proposal includes agreements with Puget and PacifiCorp regarding the payment of the $200 million reduction-of-risk discount and the FY 2007-2011 benefits for the residential and small farm customers of the region's investor-owned utilities. BPA is also proposing to offer similar terms regarding the FY 2007-2011 benefits to the other four regional investor-owned utilities. A change in the 1998 BPA Power Subscription Strategy for FY 2007-2011 is necessary to implement these agreements, and forms the third leg of this proposal.

More specifically, the agreements would require Puget and PacifiCorp to give up half of the $200 million reduction-of-risk discount and defer the other half, plus interest, until FY 2007-2011. In return, these two investor-owned utilities would receive increased certainty regarding the manner in which benefits for their residential and small farm customers in FY 2007-2011 are calculated and provided. The proposed agreements provide certainty by defining the benefits as financial payments and not power deliveries, defining a mark-to-market methodology that uses an independent market price forecast in calculating the financial benefits, and establishing a floor of $100 million and a cap of $300 million per year for these financial benefits. These floor and cap amounts do not affect payment of the $100 million deferred from FY 2005-2006. In addition, BPA would make similar offers for the FY 2007-2011 benefit calculations through contract amendments with the other four investor-owned utilities – Avista Corporation, Portland General Electric Company, Idaho Power Company, and NorthWestern Energy – in exchange for waiving a portion of the payments deferred in FY 2003. Unlike the proposed settlement, public utilities would not need to drop their pending litigation challenging the level of benefits going to the residential and small farm customers of the investor-owned utilities. The terms of these agreements are described in more detail in Attachment 1.

Removing $200 million from BPA's power costs for FY 2005-06 would make power rates about 6 percent lower in these 2 years with this agreement than without it. This year's dry spell is tending to push rates in the other direction, and could overwhelm the impacts of this and other successes at reducing costs. The actual level of power rates in FY 2005-06 depends on many factors, including the success of the Sounding Board efforts, the decision regarding the summer spill proposal, and this year's runoff and market prices. We won't know the final results for FY 2005 rates until August 2004.

Assuming BPA receives approval from its auditors, the $100 million would be deferred to FY 2007-2011 and would add $20 million plus interest to BPA's general revenue requirement for each of these 5 years. All of BPA's power customers (Slice, non-Slice, investor-owned utility, and direct-service industrial) would pay these costs. This deferral would make power rates in FY 2007-2011 about 1 percent higher with this proposal than without it.

As part of this package, BPA is proposing a change in Section III.C.2 of its 1998 BPA Power Subscription Strategy, which is shown in Attachment 2. This change simply allows the method for establishing the forecasted market price of power used in calculating the benefits for the residential and small farm customers of the investor-owned utilities in FY 2007-2011 to be determined by these new agreements. As the Power Subscription Strategy is currently written, the forecasted market price of power established in BPA's rate case would be used to calculate the benefit levels.

Your Comments are Important

Your comments are important in helping BPA accomplish the goal of reducing power rates to benefit the PNW economy and will be an important component of our decision whether or not to offer these agreements. A clear "thumbs-up" would allow us to move forward with confidence. In our efforts to provide transparency in our decision-making, we are explaining the choices and asking for your comments. Copies of the all of the relevant materials can be found at BPA's web site at www.bpa.gov/power/subscription, or by calling the Public Information Center at (503) 230-7334 or 1-800-622-4520.

Comments will be accepted until the close of business on **Friday, May 14, 2004**. Comments can be sent electronically to: comment@bpa.gov. Written comments should be sent to the following address:

Bonneville Power Administration
P.O. Box 14428
Portland, Oregon 97293

After reviewing your comments, BPA will determine in early June whether or not to proceed with these agreements and the associated change in the BPA Power Subscription Strategy. If you need additional information, please call Steve Oliver at (503) 230-3295, Larry Kitchen at (503) 230-5458, or me at (503) 230-5399.

Sincerely,

Paul E. Norman
Senior Vice President

Enclosures

Attachment 1

Summary of Terms of the Draft Agreements with Investor-Owned Utilities

Proposed Agreements with PacifiCorp and Puget Sound Energy

BPA, Puget, and PacifiCorp have negotiated the proposed FY 2007-2011 Residential Exchange Program Settlement (REP) Benefit Agreements (FY 2007-2011 Settlement Benefit Agreements) that modify the existing REP Settlement Agreements for PacifiCorp and Puget and other subsequent agreements that address the reduction-of-risk discount. The substance of the two proposed agreements is the same, and includes the following terms.

- PacifiCorp and Puget Sound Energy give up half of the $200 million reduction-of-risk discount that is part of their load buy-down agreements. They would receive payment of the remaining $100 million, plus a portion of the original amount of interest, in 60 equal payments beginning October 1, 2006. These payments would be in addition to any other benefits.

- BPA agrees now that it will provide only financial benefits in FY 2007-2011, not power.

- Puget and PacifiCorp agree to their proportional share of a cap of $300 million and floor of $100 million for the equivalent of 2,200 average megawatts of benefits established in the REP Settlement Agreements signed in 2000. The actual amount of the benefits would be determined by a market-to-market methodology that uses an independent market price forecast as described in the proposed FY 2007-2011 Settlement Benefit Agreements.

- BPA provides an extension of the period within which the two investor-owned utilities are required to pass through benefits to their residential and small-farm customers from 6 months to 36 months. This extension would provide the investor-owned utilities the opportunity to minimize volatility in their retail rates by spreading out the payments to consumers over more time.

Proposed Contract Amendments with Avista, Portland General Electric Company, Idaho Power Company, and NorthWestern Energy

BPA is proposing to make similar offers to Avista Corporation, Portland General Electric Company, Idaho Power Company and NorthWestern Energy. Since none of these utilities is entitled to any portion of the reduction-of-risk discount payments, BPA would ask these customers to waive their right to receive payment of their portion of the $55 million of Subscription financial benefits already deferred from FY 2003 that will not be returned during FY 2004. This amount is estimated to be around $3.5 million for these four utilities as of October 1, 2004. In return, BPA would provide the same terms as provided to PacifiCorp and Puget in an offer of contract modifications to the REP Settlement Agreement to these other four investor-owned utilities.

Copies of these proposed agreements and proposed contract amendments are available on BPA's web site at www.bpa.gov/power/subscription, or by calling the Public Information Center at (503) 230-7334 or 1-800-622-4520.

Attachment 2

Proposed Change to the BPA Power Subscription Strategy

In order for BPA to sign the proposed agreements with the investor-owned utilities, a change must be made to the BPA Power Subscription Strategy in Section III. This change enables the methodology outlined in the contracts BPA would sign with the investor-owned utilities to determine the market price used to calculate the residential exchange benefits for FY 2007-2011. In its current state, the BPA Power Subscription Strategy provides that the forecasted market price of power used to calculate these benefits will be established and used in a BPA rate case.

Subject: Modification of BPA Power Subscription Strategy regarding the basis for the calculation of the residential exchange benefits for FY 2007-2011, execution of proposed Agreements Regarding Payment of Residential Exchange Program Settlement Benefits During Fiscal Years 2007 through 2011 (FY 2007-2011 REP Settlement Benefit Agreement), and execution of proposed amendments to REP Settlement Agreements.

Proposal: BPA is proposing to modify Section III. C. 2 of its Power Subscription Strategy as follows:

"2. Financial Component

For the amount of subscription sales not made through physical power deliveries, BPA will provide a cash payment that reflects the difference between the market price of power determined by **either** a forecast in the rate case **or the Mark-to-Market Contract Methodology and** the rate used to make such subscription sales. **The Mark-to-Market Contract Methodology is limited to market price as determined by the following agreements: PacifiCorp, Contract No. 04PB-11468; Puget Sound Energy, Inc., Contract No. 04PB-11467; Avista Corporation, Amendment No. 3 to Contract No. 00PB-12157, Idaho Power Company, Amendment No. 3 to Contract No. 00PB-12158; NorthWestern Corporation, Amendment No. 3 to Contract No. 12160; and Portland General Electric Company, Amendment No. 2 to Contract No. 00PB-12161."**

Note: the proposed modifications in the Strategy for FY 2007-2011 are in **bold.**

Attachment 3

A Brief History of the BPA Power Subscription Strategy, the Residential Exchange Program Settlement Agreements and the Proposed Settlement of Litigation (1998-2004)

BPA Power Subscription Strategy

BPA published a Power Subscription Strategy on December 21, 1998. The purpose of the strategy is to enable the people of the Pacific Northwest to share the benefits of the Federal Columbia River Power System (FCRPS) after 2001 and retain them within the region. The Power Subscription Strategy provides a policy framework for power rate cases and power sales contracts.

One element of the Power Subscription Strategy was a proposed settlement of the Residential Exchange Program (REP) for six regional investor-owned utilities for FY 2002-2011. The Power Subscription Strategy proposed that investor-owned utilities could agree to a settlement of the REP in which they would be able to receive benefits equivalent to a purchase of a specified amount of power for their residential and small farm consumers at a rate approximately equivalent to the PF Preference rate. Under such proposed settlement, residential and small farm loads of the investor-owned utilities would be assured access to benefits equivalent to 2,200 average megawatts (aMW) of power for FY 2007-2011.

The Power Subscription Strategy noted that BPA would set the physical and financial components of the settlement amounts of benefits for the investor-owned utilities, by year, in accordance with the provisions of the settlement contracts to be negotiated. These contracts would implement the Strategy and establish that any cash payments for delivering financial benefits would reflect the difference between the market price for power forecasted in the rate case and the rate used to make such Subscription sales to the investor-owned utilities.

Residential Exchange Program Settlement Agreements

In accordance with the Power Subscription Strategy, BPA negotiated REP Settlement Agreements with the six regional investor-owned utilities, and Subscription sales agreements with the region’s public utilities and Direct Service Industries (DSIs). These agreements resulted in total firm load obligations for BPA that exceeded the capability of the Federal Columbia River Power System (FCRPS). Subsequent to execution of those agreements, power prices on the West Coast skyrocketed to unprecedented levels. To lessen the impact of these high market prices on BPA’s ability to meet these firm load obligations, on April 9, 2001, the BPA Administrator asked BPA’s customers to enter into load reduction agreements. These agreements would reduce the amount of load placed on BPA, and hence the need to purchase power to meet loads under contracts negotiated pursuant to the Power Subscription Strategy during a time of historically high and volatile market prices of power.

The Load Reduction Agreements

BPA entered into load reduction agreements with both Puget Sound Energy (Puget) and PacifiCorp that amended or replaced their original REP Settlement Agreements and that removed BPA's obligation to deliver firm power for the first 5 years of those agreements (FY 2002-2006) in exchange for cash payments. BPA used the Firm Power not sold to Puget and PacifiCorp to meet deficits in resources necessary to meet BPA's firm obligations to publicly owned and cooperative customers, investor-owned utilities, and direct-service industries.

Both load reduction agreements, PacifiCorp's Financial Settlement Agreement (Contract No. 01-PB-10854) and Puget's Amended Settlement Agreement (Contract No. 01PB-10885), specifically provided that the respective utilities were willing to reduce the payments received under their agreements to well below then-prevailing forward market price if the respective utilities entered into settlement agreements with certain publicly owned utility and cooperative customers that waived and dismissed certain legal challenges. As of June 2001, talks about potential settlement of litigation had been occurring between investor-owned utilities and public utility litigants. This provision was added to hold open the option for a reduced load reduction payment to Puget and PacifiCorp, in the event those talks were successful. These payments are known as the reduction-of-risk discount. In order for BPA to avoid paying the reduction-of-risk discount to PacifiCorp and Puget, litigation settlements with publicly owned utility and cooperative customers had to occur by December 1, 2001. The amount of the payments for PacifiCorp and Puget combined is approximately $200 million. Absent settlement, the $200 million would be recovered through BPA's wholesale power rates in the Load-based Cost Recovery Adjustment Clause (LB CRAC).

Conditional Deferral Agreements

When no settlement was reached by December 1, 2001, BPA, PacifiCorp, and Puget negotiated Conditional Deferral Agreements. These agreements deferred recovery of the $200 million in order to allow additional discussions to occur with regional parties that could settle pending litigation challenging BPA's REP Settlement Agreements with the investor-owned utilities. These agreements increased the $200 million reduction-of-risk discount payments by a negotiated interest rate over the period of the deferral.

Proposed Settlement of Litigation

A number of regional parties negotiated a proposed settlement of the public power litigation over the level of benefits going to residential and small farm consumers of the investor-owned utilities in the fall of 2003. Elements of such proposed settlement included, among other things, a proposed waiver of BPA's payment of the $200 million of the reduction-of-risk discount to PacifiCorp and Puget and a modification in the methodology for determining the forecasted market price of power used in establishing the Monetary Benefits provided under the REP Settlement Agreements for the FY 2007-2011 period. This settlement effort failed in early 2004 since not all parties to the litigation elected to participate.