AGENDA

Rates Policy Workshop
March 14, 2003; 9 am to Noon
BPA Rates Hearing Room, Portland, OR

Purpose of the Meeting: To continue the discussion regarding the customers' and BPA's approaches to solving BPA's financial situation

1. Welcome and Check Agenda	Paul Norman
2. Customer-Requested Analysis	BPA/ John Saven
3. Clarifying BPA View	
FY04 situation	BPA
3-year vs. 1-year solution	
4. General Discussion/ Way Forward	All
5. Wrap-up and Next Steps	BPA

Attachment 1	Customer-Requested Analysis
Attachment 2	Effects of deferring the SNCRAC process
Attachment 3	Why a Multi-Year SN CRAC?
Attachment 4	Status of Elements of Customer Proposal for Cost Reductions, Deferrals, and Revenue Improvements

To participate by phone, please call Cynthia Jones at 503-230-5459
or Cain Bloomer at 503 230-7443

Attachment 1

Customer-Requested Analysis

In our meeting on Friday, March 7, John Saven requested these two analyses:

1. Assume $23M in revenue improvement for 03 due to hydro and fish credits; assume $15M + $30M in cost cuts in 03; assume $15M + $50M in cost cuts in 04 (beyond the numbers in BPA's Initial Proposal).
2. Additionally assume a deferral of $55M in BPA payments to IOUs in 04, and assume settlement of litigation that decreases BPA costs by $67M in 04.

- Both analyses should assume that $100M of cash from ENW refinancing is available in 2003 but must be returned by 2006.

Results

Table 1

Analysis	2003 TPP	2004 TPP	2004-6 TPP	2006 TRP
1.	96%	52%	10%	11%
2.	96%	74%	41%	38%

These analyses use BPA's Initial Proposal data, with no changes other than the three noted above.

- Initial Proposal assumption re $55M/year IOU payment: cash payment for 2003 is deferred out of the rate period, unless there is a SN CRAC in 2004, in which case the 2003 payment is made in 2004 with 3% interest. Expense in each year remains (cash accounting and expense accounting differ.)
- Assumption in these two analyses: there is no SN CRAC, so 2003 cash payment is deferred out of the rate period.
- Assumptions in these two analyses for 2005 and 2006: cash payments of $55M/year each year also deferred in Analysis 2; expense and cash outlay both lowered by $67M in 2005 and 2006 in Analysis 2 as part of litigation settlement.

Attachment #2
Effects of Deferring the SNCRAC Process: High financial risks

- **Additional cost reductions and revenue increases are not done.** All of the $754 million in of cost cuts and revenue increases in the customer alternative should be pursued, but none of it can be counted on now, except for $20 million of BPA internal power-related cost reductions in addition to the $140 million already done. Virtually all the $754 million requires the agreement of other institutions that has so far not happened (or requires cooperation of the weather and markets). BPA has been pursuing all of these, many for months. Virtually none is unilaterally achievable by BPA. (See Attachment 4 for outlook on each potential cost reduction and revenue improvement)

- **Relying on uncertain financial improvements, and then not getting them, could mean financial disaster or a much higher rate increase.** If we defer the SNCRAC process and get none of the $754 million of financial improvements except $20 million more internal cost reductions:

  TPP in FY04 with no SNCRAC: 15%
  SNCRAC in April 2004 to bring FY 04 TPP back to 50%:
  59% increase in base rates
  37% above FY 03 rates

- **Extraordinary cash tools will be needed, even with a SNCRAC.** Extraordinary cash tools, like use of ENW refinancing proceeds or the Treasury note, are BPA's last line of financial defense. Even with an SNCRAC in 2004, there is good chance that BPA will need these last-defense tools to meet obligations, both in the fall of 2003 and the fall of 2004. Using $100 million of ENW refinancing proceeds to avoid a SNCRAC means that the last line of defense is that much smaller.. The SNCRAC is important to replenishing this tool. Without it, BPA's risk is increased and the prudence of using such a tool is called into question.

- **BPA has already lowered financial standards, to mitigate rate impacts.** The rate case standard for TPP is 80 to 88% for five years, translating to over 90% for individual years. The TPP target for individual years in the SNCRAC proposal is 50% in combination with a 3-year 'Treasury Recovery Probability' (not TPP) of 80%. Also, in the SNCRAC proposal the power business line can use transmission reserves to achieve a higher TPP, departing from the prior standard of a power-only TPP. Returning to the rate case standard for TPP would require a far higher SN CRAC. We are proposing a lower TPP standard to recognize the severe impacts of a rate increase while still achieving our traditional level of TPP by the end of FY 06. See Table 2.

Table 2
Impacts of TPP Standards on a One-Year SN CRAC

One-year TPP	Five-year TPP	One Year SN CRAC for FY 04 above base rates	Rate increase for FY 04 above FY 03 rates
PBL – 95.6%	PBL – 88%	66%	42%
BPA – 95.6%	BPA – 88%	58%	37%

- **SNCRAC process deferral probably means further credit rating downgrades.** This week, BPA's credit rating was downgraded by Fitch as well as placed on "negative outlook" by Standard and Poors, even in view of the expectation that BPA will proceed with the SN CRAC process and shore up its TPP and liquidity positions. These credit concerns likely reduce the beneficial effects of ENW April refinancings that we hoped would reduce the SN CRAC when finally calculated in May. Putting off the SN CRAC process will result in additional downgrades, which will add costs and/or cause damage to BPA's debt optimization program, the source of funds that the customers would have us rely on. The S&P report states that a downgrade could be prompted by "the use of any debt restructuring savings to offset current operating expenses..", "failure to implement an adequate SN CRAC…", or "any restructuring of federal Treasury obligations".

Additional Notes Regarding Impacts of Different TPP Criteria on a Potential SN CRAC

- BPA's long-term TPP standard is 95% for a two-year period, equivalent to 88% for a five-year period. BPA relaxed this to 80% for a five-year period during the discussions of the Fish Funding Principles. BPA then applied this to PBL-only rates and cash in the 1996 rate case for FYs 1997 through 2001, and again in the 2002 rate case for FYs 2002 through 2006. This means that the cash reserves attributable to PBL plus the cash flow generated by PBL rates and revenues should have an 88% probability of being sufficient to cover the PBL portions of the Treasury payment for all five years.

- If we look at a one-year SN CRAC, we essentially have a one-year rate period. The one-year TPP that corresponds to an 88% five-year PBL TPP is 95.64%. An SN CRAC for 2004 alone sufficient to produce a PBL one-year TPP of 95.64% is 66% (above base rates), or an increase in total non-Slice rates from 2003 to 2004 of 42%.

- BPA has relaxed this standard by moving to a whole-BPA TPP test for SN CRAC purposes. The 2004 SN CRAC needed to produce a BPA 2004 one-year TPP of 95.64% is 58% (above base rates), or an increase in total non-Slice rates from 2003 to 2004 of 37%.

- If BPA were to relax the TPP standard further, and aim for a BPA TPP of 80% for 2004, the needed SN CRAC would be 42% (above base rates), or an increase in total non-Slice rates from 2003 to 2004 of 26%.

- These all assume Initial Proposal data with the additional inclusion of $20M in cost cuts BPA has already pledged as part of reducing costs to the level of 2001 actuals, assuming the $20M is achieved in equal parts in 2003 and 2004.

Attachment 3

Table 3

Why a Multi-Year SN CRAC?

	Five Year Equivalent TPP	**TPP Criterion**	**SN CRAC (% over base rates)**	**Total rate increase above total 2003 (incl. all CRACs)**
One Year SN CRAC for FY 04	80%	One year at 95.6%	58% for FY 04	37% for FY 04
3 Year Fixed SN CRAC	80%	Three year at 87.5%	48% for FY04-06	30% for FY04-06
BPA Initial Proposal (variable SNCRAC)	n/a	TRP in FY 06 of 80% AND FY04-06 TPP of 50%	30% EV for FY04-06 *	15.6% EV for FY04-06 *

Note: The first 2 cases assume Initial Proposal data with the additional inclusion of $20M in cost cuts BPA has already pledged as part of reducing costs to the level of 2001 actuals, assuming the $20M is achieved in equal parts in 2003 and 2004. The initial proposal does not include these. However, if you do, the impact is less than 1 percentage point (29%, 15.2%).
* EV = Expected Value

- **Is the 3-year SNCRAC proposal aimed at rebuilding BPA reserves to original 02 Rate Case levels of $600 million?** No. The BPA 3-year proposal would only recover reserves to around $300 million by the end of 2006 – a level considered minimal.

- **3-year TRP allows a lower SNCRAC.** If a one year SN CRAC is established at a sufficient level to provide an 80% probability that we pay Treasury in FY 04 (still low by normal standards), it would have to be extremely high. The three-year approach allows BPA to make the case that we are on path to recovering TPP by 2006 (the 80% TRP standard in 2006).

- **<u>Year-by-year SNCRAC, aimed at 50% TPP, means very low 3-year TPP</u>**. The customer alternative suggests that the need for SNCRAC is assessed each year, based on a 50% TPP standard for that year. Just barely bringing TPP to 50% for each of the next three years means a 3-year TPP of about 13% -- an 87% chance of at least one failure to pay Treasury.

- **<u>Year-by-year SNCRAC also risks extremely high SNCRAC in 2005 and 2006</u>**. If the total financial shortfall is in the ballpark of current BPA estimates, compressing the period of recovery by deferring the SNCRAC process means creating a much bigger rate problem in 2005 and 2006. (Having no SNCRAC in FY 04 would force the FY05 and 05 SNCRAC rate to be 1.5 times the size of what the 04-06 SNCRAC would have been.)

- **<u>BPA must set its rates to recover its costs</u>**. We need to demonstrate to FERC that we are setting rates sufficient to cover our costs. Under our current rates, including an assumption that we will have an FB CRAC, we have negative net revenues in each of the 4 years (FY 03-06).
(FY 04 -$123M, FY05 -$117M, FY06 -$99M), on top of negative net revenues in FY02 and FY03.

- **<u>Year-by-Year SNCRAC increases likelihood of cost deferral and makes clarification of long-term difficult:</u>** Addressing the need for SN CRAC each year makes it more likely that a bow wave of losses will be built up, and pushed out past 2006. As long as this prospect exists, BPA's post-2006 cost structure remains more uncertain, making it harder to resolve post-2006 issues.

Attachment 4

Status of Elements of Customer Proposal for Cost Reductions, Deferrals, and Revenue Improvements

Cost Reduction or Revenue Improvement	FY 03-06 Total	Status as of March 2003
Use of ENW Refinancing Proceeds to increase TPP, reduce rate increase	Customers propose temporary use of $100 million.	Inconsistent with BPA agreement with ENW Board. Board does not currently support. Use in this way eliminates this as a last-resort tool to maintain liquidity – and BPA may need last-resort tools in next 2 years. Results in reduced bond ratings and higher capital costs.
"First Round Cost Reductions". Internal cost reductions	Customers propose $70 M	The label is misleading, since BPA has already reduced internal costs by $140 million. BPA has committed to another $20 million in cuts, which would be part of this $70 million, as part of commitment to stay at FY 01 actuals for net internal operations costs. BPA is working on additional internal cuts, but another $50 million is not achievable without fundamental cuts in mission.
"Second Round Cost Reductions" Renegotiations: $30M Generating System: $50M Debt Service: $140M	$220 M	BPA is working actively to achieve $30 million in savings from augmentation contract renegotiation, but not done with these yet. Further savings at hydro and nuclear plants are not supported by Corps, Bureau, ENW and may push O&M costs below levels consistent with reliability and safety. Additional debt service reductions of up to $140 million may be possible, but cannot be counted on now.
IOU Deferrals, and Settlement of the IOU/ public Litigation	$365 M	BPA has been pursuing this for several months. To date, IOUs have required BPA agreement with Joint Customer Proposal for 20-year benefit formula post-2006 before agreeing to these. Would require the approval of 4 state commissions and willingness of the IOUs. Talks are underway on this, but are unlikely to get to closure for months.
Additional Net Secondary Revenues	$98 M	Requires the cooperation of nature and volatile markets.