Draft Closeout Report: BPA's Proposed Changes to PFR Base Costs

The following pages describe proposals from BPA and PFR participants for cost reductions and cost increases from the PFR Base forecast and BPA's proposed draft conclusion on each, and is subject to additional comment through May 20, 2005.

TRANSMISSION PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Transmission Purchases, and Reserve/Ancillary Services	$171 M/yr	$0 M/yr
FY 2007-2009 PFR Base Forecast	$189 M/yr	$0 M/yr
FY 2007-2009 Proposed PFR Forecast	**$184 M/yr**	**$0 M/yr**

The Transmission Acquisition Program represents costs associated with services necessary to deliver energy from resources to markets and loads. These costs include: transmission, ancillary services, real power losses, generation integration costs associated with the U.S. Army Corps of Engineers and Bureau of Reclamation transmission facilities, and metering and communication requirements.

The Transmission and Ancillary Service component represents costs associated with payments to BPA's Transmission Business Line for transmission and ancillary services associated with surplus sales. The goal of the BPA PBL transmission strategy is to determine the least-cost mixture of long-term and short-term transmission products that can meet the needs of PBL's surplus marketing strategy.

Possible Decreases Identified

1. **Proposal: Model the transmission expense associated with secondary energy at the minimum expense across the 3000 secondary energy scenarios rather than the average of 3000 secondary energy scenarios** – This is an issue to be decided in the rate case. BPA's intention is to keep a consistent treatment of secondary sales and transmission costs. Counting transmission costs associated with critical water but crediting rates with sales from average water would understate the expense associated with transmission for the sales from average water. **Draft Conclusion: No change in modeling of transmission expense.**
2. **Proposal: Reduce forecast for Metering/Telemetry/Equipment Replacement** - The metering, communications and TBL Engineering support component represents costs associated with the installation of metering, telemetry, communications equipment & replacements and ongoing charges to meet increasing PBL business requirements for frequency and granularity of meter data. In the PFR forecast there was $1 M/year spending level for equipment associated with forecasted future data needs. We have learned that in the future when this happens TBL will acquire the equipment and capitalize it so there is not a need to forecast for these costs in PBL anymore. There will continue to be ongoing costs associated with communications, which are expected to remain in the PBL expense forecast. Therefore, BPA concludes the

Telemetry/Equipment replacement forecast should be reduced from $1 M/year to $200 K/year. **Draft Conclusion: Remove metering/telemetry costs of $800 thousand/year.**

3. **Proposal: Reduce 3rd Party GTA Wheeling Forecast –** Revised forecast for 3rd Party GTA Wheeling because when preparing the forecast there was an error in the formula when calculating the costs for the South Idaho OATT. The formula was double counting the expenses twice and then adding the inflation rate. **Draft Conclusion: Include update to reduce forecast by $4 M/year.**

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Remove Metering/Telemetry Costs	($0.8 M/year)
Updated 3rd Party GTA Wheeling Forecast	($4 M/year)

CONSERVATION PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Conservation Program (including rate credit)	$66 M/yr	$27 M/yr
FY 2007-2009 PFR Base Forecast	$71 M/yr	$32 M/yr
FY 2007-2009 Proposed PFR Forecast	**$70 M/yr**	**$28 M/yr**

The portfolio of energy efficiency programs BPA is proposing for the post-2006 period is very similar to what is currently available. BPA relied heavily on the Post-2006 Conservation Workgroup's recommendations in designing its proposed program approach. The key features of the proposed program are as follows:

1. a **rate credit program** (similar to the current C&RD with key changes, such as paying for only cost-effective measures, BPA incentives based on a % of what it costs to install measures and not value to the system, and requiring that measures be incremental, measurable, and verifiable with appropriate oversight and more frequent reporting);
2. a **bi-lateral contracts program** for our utility and federal agency customers (similar to the current ConAug program);
3. a **3rd party bi-lateral contracts program** for cost-efficient, region-wide approaches (similar to the VendingMi$er program and includes BPA's support for the NEEA);
4. support of critical **infrastructure** elements, especially evaluations so we know if we are getting what we are paying for;
5. a separately funded **renewable resource option**; and
6. a proposed spending amount of **$75 million/year** to capture BPA's 52 aMW/year share of the Northwest Power and Conservation Council's (Council) regional cost-effective conservation target at an overall cost of **$1.4 million/aMW.**

Through the PFR process, several areas where decisions are yet to be made were identified as either potential savings or increases to the Conservation spending level from the PFR base. Each of these areas were discussed and taken into consideration when developing the proposed FY 2007-2009 Conservation forecast.

Possible Decreases Identified

1. **Proposal: Credit conservation done by utilities "on their own nickel" against BPA's target, reducing BPA's spending** – BPA's conservation target is based on cost effective conservation as defined in the Council's 5th Power Plan and reflects only loads BPA serves. Also, BPA serves only a fraction of some public utilities' loads. BPA agrees that if those utilities are effectively meeting some of BPA' target through their own non-BPA-funded programs, then BPA should not separately forecast for the same conservation MWs. BPA does not believe that currently there is enough information on how much cost-effective conservation public utilities are accomplishing on their own to warrant forecasting a reduction now. However, BPA will track this going forward and adjust its forecast accordingly. If this can be done before final studies are done for the FY 2007-2009 rate period, this adjustment will be made before the final rate decisions are made. **Draft Conclusion: Do not include this reduction in Initial Proposal, but possibly**

include it in final rate studies.

2. **Proposal: Reduce BPA target for "naturally occurring" conservation** – BPA originally set the target at 40%, which is roughly the percent of the regional load BPA serves (7,782/20,472 aMW= 38% based on FY 2003 White Book information). This calculation is fully consistent with the methodology for setting conservation targets in this FY 2002-06 period, as agreed to between BPA and the Council. After consultation with the Council's staff, BPA estimated which specific measures are likely to become standard practice in absence of any BPA/utility conservation programs. Based on this analysis, BPA estimated that roughly 7% of the Council's targets would be naturally occurring. Seven percent equates to roughly 4 aMW out of BPA's 56 aMW annual target. Based on the loads BPA serves, our share of the Council's regional target over the FY 2007-2009 period is 168 aMW (40% of 420 aMW). This equates to an annual target of 56 aMW. We anticipate that the "naturally occurring" conservation will come in at about 7% or 4 aMW/year. This would give us a 52 aMW/year target and a 156 aMW target over the 2007-09 period. While there has been some comment that the Council has set too high a target for conservation, BPA believes it appropriate and achievable. The Council conducted an extensive public process as conservation potential was analyzed, and BPA and many others in the region participated in that process. Thus, BPA concludes the 52 aMW per year is the right target. **Draft Conclusion: Include $4 million annual capital and $1 M annual expense reductions in the rate case initial proposal.**
3. **Proposal: Don't require load decrement on rate credit** – PFR participants commented that it will be harder for BPA to meet its MW targets for conservation within its spending level limit if it requires block and slice customers to reduce their load on BPA by the amount of conservation they accomplish under the conservation rate discount program. Consistent with the advice of its Post-2006 Conservation Workgroup, BPA has now proposed not to require load decrements from slice/block customers under the rate credit program, but continuing to require load decrements under the new bi-lateral contract program. **Draft Conclusion: Make the change recommended, but no reduction in costs.**

<u>**Possible Increases Identified**</u>

4. **Proposal: Do not count IOU conservation BPA pays for toward BPA's target, or count these MW's but also add IOU residential conservation to BPA's target** – BPA proposes to count toward the 52 aMW annual target any cost effective conservation it helps ensure through its funding mechanisms, including the conservation achieved by IOUs under the rate credit program and the conservation accomplished by our Northwest Energy Efficiency Alliance (NEEA) funds. This decision is consistent with the current way we count delivered savings toward our share of the Council's target in the rate period as agreed to by Council staff. Further, BPA invests in regional conservation that is currently counted toward BPA targets, e.g., NEEA market transformation. Counting conservation funded by IOU rate credits is fully consistent with the methodology we use in this rate period, and should be extended to the FY 2007-2009 rate period. If BPA pays for it, BPA should count it toward our targets. **Draft Conclusion: Count IOU MW's and add to target, but no cost increase.**

5. **Proposal: Increase spending to increase certainty of meeting conservation targets** – BPA acknowledges that the $1.4 M/aMW target is a stretch. Based on recent conservation program performance and given the changes that have been made in the designs of the proposed program portfolio, BPA believes it has a reasonable chance to achieve its share of the Council's new conservation aMW targets with the proposed spending level. It is important to note that while BPA is targeting $1.4 M/aMW, that figure is an average of different program spending levels. BPA has been successful at lowering the cost of savings through the Con Aug Program, and BPA will seek to continue to average program costs in the revised bilateral contracts at the current level ($1.2 M/aMW). Similarly, the NEEA has a demonstrated track record of $1 M/aMW. This leaves the budgets for local initiatives higher ($1.7 M/aMW). Thus, the success to date with driving down program costs and continuing to adapt new marketing strategies leads BPA to believe these forecasted targets are achievable. Just as important, BPA believes that setting and meeting aggressive costs containment goals is important both to keep rates down and to maintain support for steady conservation funding, since higher costs per MW make conservation spending levels less sustainable during periods of even greater financial stress. BPA will assess progress towards our aMW conservation goal and proposes to adjust for underperformance against the target in the next rate period. **Draft Conclusion: Keep funding at current forecast.**
6. **Proposal: Increase spending level for administrative costs** – BPA is proposing to pay up to 10% of administration costs under the new rate credit and bilateral contracts program. The Conservation Workgroup recommended 20% of administrative costs be included. The current C&RD credit allows credit of 20% for administration cost to support infrastructure building. For ongoing conservation programs, however, administration should be lower. A number of utilities and end users that are partners in capturing the regional conservation have told BPA they don't need a full 20% administration for on-going programs. BPA has included a number of activities and tools that should reduce utility administration costs (e.g., standard program design templates and marketing materials, mechanism for utility sharing, etc.). However, BPA received numerous written comments on this topic shortly before issuing this report and will consider them during the comment period. **Draft Conclusion: Keep funding at current forecast.**
7. **Proposal: Increase spending level for conservation infrastructure** – The Conservation Workgroup recommended a 2% infrastructure spending level (i.e., $1.6 M/year). BPA has proposed instead conservation spending levels for FY 2007-2009 that includes $1 M/year for the infrastructure spending that should be sufficient to cover these activities. The 2% infrastructure support forecast was not based upon detailed analysis and budgeting. More detailed analysis developed by BPA leads the Agency to conclude the necessary infrastructure support can be accomplished at the $1 M/year level. The $1 M/year is a component of the $75 M/year proposed conservation acquisition program level. **Draft Conclusion: Keep funding at current forecast.**

Table 1: Proposed Conservation Program Annual aMW Targets and Spending Levels

Program	aMW	Forecast	Cost/aMW
Rate Credit (at 0.5 mills = $42M*/year with IOUs and Pre-Subers included)	21	$36M	$1.7M
Utility & Fed. Agency Bi-Lateral Contracts	15	$21M	$1.4M
3rd Party Bi-lateral Contracts	6	$7M	$1.2M
Market Transformation (via NEEA)	10	$10M	$1.0M
Infrastructure Support and Evaluation	---	$1M	---
Total	52	$75M	$1.4M

* - *assumes $6M/year of the $42M/conservation rate credit will be spent on renewables .*

In total, BPA proposes to reduce the base PFR spending levels (both capital and expense) for achieving the Council's cost-effective conservation target by $5 M/year to $75 M/year (includes the conservation rate credit), which is a portion of the overall Conservation forecast of capital and expense spending. The proposed spending level is an actual increase of $5 M/year over the average annual spending level in the current rate period.

Table 2: PBL Total Proposed Conservation Forecast FY 2007-2009

Program	Proposed Forecast	Annual MW Target Spending
Generation Conservation Expenses	**$34.0 M**	
EE Development (Reimbursable)	$12.9 M	
Energy Web/Non-Wires Solutions	$1.0 M	
Technology Leadership	$1.3 M	
Legacy (Contract closeout after FY 2000)	$2.8 M	
Low-Income Weatherization	$5.0 M	
Market Transformation	$10.0 M	YES
Infrastructure Support and Evaluation	$1.0 M	YES
Conservation Rate Credit	**$36.0 M**	**YES**
Expense Total	**$70.0 M**	
Generation Conservation Capital Total	**$28.0 M**	
Utility & Fed Agency Bi-Lateral Contracts	$21.0 M	YES
3rd Party Bi-lateral Contracts	$7.0 M	YES

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Reduce Conservation Expense Spending Level	($1 M/year)
Reduce Conservation Capital Spending Level	($4 M/year)

RENEWABLES PROGRAM

	Average Expense	*Average Net Cost**	Average Capital
FY 2002-2006 Renewable Program	$22 M/yr	*$2 M/yr*	$0 M/yr
FY 2007-2009 PFR Base Forecast	$56 M/yr	*$13 M/yr*	$0 M/yr
FY 2007-2009 Proposed PFR Forecast** *w/o Rate Credit*	**$61 M/yr** *$55 M/yr*	***$15 M/yr*** *$9 M/yr*	**$0 M/yr** *$0 M/yr*

**Takes the Average Expense column and subtracts the estimate of revenues from the renewables program.*
***Includes Renewable rate credit of $6M/year in Average Expense. Previous forecasts did not.*

BPA began funding renewable-related research nearly 30 years ago through solar monitoring, a wind demonstration project, geothermal and wind resource assessments, and a range of projects across other technologies, many in cooperation with other sponsors. As part of the Short-Term Regional Dialogue process, BPA decided in February 2005 to focus on facilitation of regional renewable resources by its customers and others, and to limit its financial contribution to a net cost of $21 million per year. BPA has identified a menu of facilitation actions and is consulting with a regional workgroup on which of those actions will maximize the amount of renewable resource development, within BPA's financial contribution limit. This group has advocated, and BPA agrees, continuing to include renewables in the utility actions eligible for the rate discount program for FY 2007-2009 at the level of $6 million per year. This leaves much of the $21 million annual net cost limit uncommitted due to higher long range market price forecasts that produce a break even cost for existing renewable contracts (the room under the target will vary as long range market price forecasts change). Rather than simply assume the entire $21 million level is spent, BPA intends to include the best estimate of actual spending in the rate case cost forecasts. This was the basis of the PFR base case cost levels.

Through the PFR process, participants have identified several areas that would both increase and decrease portions of the FY 2007-2009 renewables spending level forecasts.

Possible Decreases Identified

1. **Proposal: Remove the Calpine geothermal project from projected costs** – The assumption in the PFR base is that the Calpine project comes on line in FY 2007 and operates during the rate period. The Calpine contract is currently in arbitration and a decision is not expected to come until late summer. Some PFR participants urged that BPA assume that it will not have to purchase the high-cost output of this project, or that its online date will be significantly delayed. BPA believes that it is highly unlikely that it would be purchasing output from this project any sooner than FY 2009, even if BPA loses in the ongoing arbitration process. Therefore, BPA is proposing to move the forecast of the geothermal out of FY 2007 and FY 2008 but leave it in the forecast for FY 2009 for the power rate case initial proposal. BPA does not believe the project costs should be removed entirely until the outcome of the arbitration is known. This forecast will be revised in time for the final rate proposal after the arbitration decisions have come about late this summer. **Draft Conclusion: Remove geothermal project costs in FY 2007 and 2008.**

2. **Proposal: No further renewable spending beyond what is already contractually committed** – This option was not actually advocated by PFR participants, but was included by BPA as a "bookend" for discussion. Having recently decided on the $21 million limit after an extensive public process, BPA does not believe it is appropriate to now "zero out" its renewable resource support. **Draft Conclusion: Do not "zero out" incremental renewable resource facilitation.**

<u>**Possible Increases Identified**</u>

3. **Proposal: Add facilitation forecast for FY 2007-2009 if Calpine is taken out of the forecast** – Removal of the Calpine geothermal project allows other facilitation actions to be added without exceeding the $21 million annual net cost limit. Some PFR participants and Renewable Workgroup members supported this. Others also recommended that the facilitation spending estimate be revisited annually in consultation with customers and together they would jointly assess the need for facilitation spending. BPA agrees that its rate proposal costs should include reasonably foreseeable renewable facilitation costs, but not simply "placeholder" dollars up to the $21 million limit. Based on work to date with the Renewables Workgroup, BPA believes the best estimate of this is $5.5 million in FY 2007 and $11 million in FY 2008. This estimate will be updated before final rate studies are done in consultation with customers. **Draft Conclusion: Include $5.5 million in FY 2007 and $11 M in FY 2008 for renewable facilitation actions.**
4. **Proposal: Include a Renewable Rate Credit** – The current rate period combines the renewable and conservation rate credit into one lump sum. Through the Conservation and Renewables Workgroups it has been proposed to separate this credit into distinct categories. BPA also heard the desire to give customers the option of committing for one year at a time rather than for all three years at once. The PFR base forecast did not have the renewable rate credit embedded. **Draft Conclusion: Include the $6 M/year rate credit.**

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Remove forecast of Calpine from FY 2007-2008	($11 M/year for FY07-08)
Include facilitation forecast for FY 2007-2008	$8 M/year for FY07-08
Include renewable rate credit	$6 M/year

INTERNAL OPERATIONS CHARGED TO POWER

	Average Expense	Average Capital
FY 2002-2006 Internal Operations Charged To Power Rates	$107 M/yr	$0 M/yr
FY 2007-2009 PFR Base Forecast	$116 M/yr	$0 M/yr
FY 2007-2009 Proposed PFR Forecast	**$110 M/yr**	**$0 M/yr**

This cost category is driven by BPA's strategic direction: "Effective cost management (with emphasis on best practices, innovation and simplicity) through our systems and processes." It includes BPA staffing costs, travel, training, consultant contracts, building leases, IT services, and other related costs. BPA has been managing these costs very actively over the last several years and has kept the rate of growth well below the rate of inflation over the last four years. Several actions are underway now to bring these costs down further, including an agency-wide process review, reduction in high-graded positions, and consolidation of functions currently performed in both power and transmission business lines. The primary challenge for the PFR process is determining the level of savings to include from these ongoing efforts since they will not conclude before the PFR process concludes in June. PFR participants urged BPA to include its best estimate of savings from these efforts in its PFR conclusions.

Possible Decreases Identified

1. **Proposal: Reduce monetary awards** – During the current rate period, BPA drastically reduced award budgets in response to the financial crisis the region faced. In the FY 2007-2009 base PFR forecasts BPA proposed to increase these levels, but not to historic levels, and tied them to financial standards. If the financial standards are not met the awards are not paid out. This item was an area identified as a place to reduce the spending forecast in the PFR process. Advice from PFR participants was to keep the increased awards amounts but to make sure they are tied to financial performance standards. BPA agrees with this and proposes to maintain the amounts included in the base PFR forecast. **Draft Conclusion: No reduction in awards cost.**
2. **Proposal: Include forecast of savings from process improvement efforts** – BPA is in the middle of its efficiencies studies so many of the identified areas of possible reductions have not been fully studied and resulting savings quantified. However, many customers have voiced concern that these efficiencies will not be reflected in their FY 2007-2009 power rates unless savings are forecasted now. BPA agrees with this concern. As an interim target for inclusion in the initial rate proposal, BPA proposes to reduce its total internal costs allocated to power rates in FY 2007-2009 to roughly the same amount as spent on these functions in FY 2001, with no allowance for inflation. This is a reduction of $8 million per year from the PFR base. Given that BPA's responsibilities have increased and will continue increasing over this 8-year period, absorbing inflation in internal spending will require significant success in the ongoing efforts to improve internal processes along with reductions in staffing. Based on progress to date on these efforts, BPA is sufficiently confident in its ability to meet this target to include it in the initial rate proposal. Internal costs will be updated before the final rate studies are done in 2006. **Draft Conclusion: Reduce internal costs by**

$8 million per year to reflect process improvement efforts.

<u>**Possible Increases Identified**</u>

3. **Proposal: Include but reduce spending level of uncommitted technological innovation spending (TCI)** – The mission of the Technology Confirmation / Innovation Program is to confirm the potential application of emerging technologies to BPA's enterprise to achieve BPA's strategic objectives more effectively and efficiently. Total TCI funding consists of the (1) base level of funding that is already incorporated into organizational forecasts and (2) incremental funding. The proposed funding in the Corporate G&A forecasts in the base PFR forecast is for incremental funding. BPA proposed to add to the base level of funding gradually, to yield a total TCI level that would be in the range of 0.3% - 0.5% of revenues by FY 2011. However, after listening to participants and customer concerns about adding additional costs to this rate period, but also understanding there is support for spending money on these efforts based on the belief that the electric industry is under-spending in this area and that the potential rewards from applied technologies can far exceed the development costs, BPA proposes to scale back but not eliminate incremental TCI funding. The resulting reduction in corporate TCI costs to $2.4 M/year (which translates to PBL costs of approximately $1.3 M/year) is a reduction from the corporate TCI PFR base of $400 K/year. These numbers assume that both PBL and TBL undertake TCI-related actions over these years at levels that have been indicated in earlier discussions. For example, it is assumed that PBL will be picking up its half of the Bureau of Reclamation's hydro R&D expenses beginning in FY 2006 and that Energy Efficiency's TCI-related expenses will continue. **Draft Conclusion: Include the TCI forecast of $1.3 M/year in Internal Operations Charged to Power.**

TCI Program Proposal	FY 2006	FY 2007	FY 2008	FY 2009
PFR Base Total	0	0	0	0
PFR Workshop Total	$250	$1,500	$2,750	$4,100
Proposed PFR Total	**$ 500**	**$ 1,400**	**$ 2,400**	**$ 3,400**
PBL Share	*$ 250*	*$ 1,000*	*$ 1,200*	*$ 1,700*
TBL Share	*$ 250*	*$ 400*	*$ 1,200*	*$ 1,700*

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Include TCI forecast in Internal Operations Charged to Power	$1.3 M/year
Include process improvements in Internal Operations Charged to Power Forecast	($8 M/year)

HYDRO SYSTEM O&M AND CAPITAL INVESTMENTS: CORPS OF ENGINEERS AND BUREAU OF RECLAMATION PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Corps and Reclamation	$196 M/yr	$110 M/yr
FY 2007-2009 PFR Base Forecast	$242 M/yr	$138 M/yr
FY 2007-2009 Proposed PFR Forecast	**$240 M/yr**	**$138 M/yr**

The Corps of Engineers (Corps) and Bureau of Reclamation (Reclamation) operate and maintain the hydro system that produces around 90% of BPA's power under average water conditions. The age and conditions of the facilities under each of these organizations is different, resulting in different needs and proposed spending levels in the base PFR forecast. Through the Sounding Board process, the agencies recognized that they need to be able to succinctly explain the hydro program's resource requirements. In the PFR process we've presented detailed information about the asset management business model we operate the hydro system under, as well as very specific data used to determine the resource requirements that comprise the FY 2007 to 2009 forecasts. Because these forecasts are one of the larger components of costs that will make up the FY 2007 to 2009 rate: BPA, the Corps, and Reclamation have worked very hard to develop budgets that reflect minimum cost requirements while still meeting the systems operational, power generation and reliability requirements for the region. There was much concern about the increase from prior funding levels in the O&M and capital forecast from some PFR participants in the FY 2007-2009 timeframe. Much of this increase is due to the Corps and Reclamation adopting a long term asset strategy for management of the hydro facilities, and to enable the Corps to shift from a mode of breakdown maintenance to preventive maintenance. The age of the hydro facilities is also playing a part in the O&M forecasts where extraordinary maintenance items are starting to occur at the same time that there are increased costs from security mandates. Even with these cost increases, Corps and Reclamation costs are below industry O&M benchmark costs (excluding F&W costs). Even though there are many cost issues facing the Corps and Engineers and Bureau of Reclamation such as aging facilities and increased security and F&W costs, the PFR was still able to identify a few areas to decrease the base PFR forecast by relatively small amounts. Additionally there are longer-term efforts to manage costs that may yield savings in the future and the agencies are willing to engage in focused benchmarking efforts against Mid-Columbia hydro projects owned by BPA customers.

<u>Possible Decreases Identified</u>

1. **Proposal: Reduction in funding for WECC/NERC compliance** – The PFR base includes a forecast needed for compliance requirements. Although the final review of our program to manage these requirements will not be completed until the end of June, preliminary results are indicating that compliance can be achieved for about $1.5 M less than the initial estimate. There is still some level of risk associated with this value; both in terms of the uncertainty until the review is complete and in terms of any new WECC/NERC requirements that are not forecasted. BPA believes this is an acceptable level of risk and proposes to include the $1.5 M/year savings in the PFR forecast with the ability to update that assumption in the final rate proposal after the studies have been concluded. **Draft Conclusion: Include $1.5 million annual reduction.**

2. **Proposal: Reduce proposed level of funding for extraordinary maintenance** – There currently is a forecasted need of $18 M/year for extraordinary maintenance items in the FY 2007-2009 time period and beyond, but only $8 M/year is included in the base PFR forecast. Some of the participants in the PFR workshops questioned that spending appeared to continue to increase over time even though some of the lagging performance indicators show acceptable performance standards for some time periods. BPA is concerned about the age of the facilities and the power generation and revenue impact if the spending for extraordinary maintenance items is eliminated, directly impacting system performance. BPA proposes to keep the $8 M/year in extraordinary maintenance costs, understanding there are more projects identified than funding available. The Corps, Reclamation and BPA will continue to use a step-up approach to the proposed extraordinary maintenance costs that specifically identifies the projects to be funded and their priority in terms of benefits to the system and dollar impacts. **Draft Conclusion: No reduction in costs for extraordinary maintenance.**
3. **Proposal: Eliminate discretionary overtime funding** – This category has small dollars attached to it but big impacts. The discretionary overtime forecast is designed to fund work that is needed in order to get a unit back in operation as soon as possible to help avoid lost revenue. BPA does not recommend eliminating this item due to concerns about impacts on unit availability and power generation. **Draft Conclusion: No elimination of forecast for discretionary overtime.**
4. **Proposal: Reduce costs of management of security requirements** – The Corps, Reclamation and BPA are working closely to be as efficient as possible in carrying out security responsibilities, but security requirements included in the base PFR are mandatory for the Corps and Reclamation. **Draft Conclusion: No reduction in security management costs.**
5. **Proposal: Benchmark against similar regional hydro facilities to capture efficiencies** – The Corps and Reclamation has participated in industry benchmarking for the past four years along with other regional hydro facilities. One way to capture savings over time is to find more efficient ways to perform the work required. During the PFR workshops it was suggested that facilities with similar operations on the Mid-Columbia get together and share information on costs and ideas on efficiency gains. BPA, the Corps and Reclamation embrace this proposal and intend to pursue it. BPA proposes that any savings from this effort be accounted for in the final rate proposal after the project is underway and potential savings are identified. **Draft Conclusion: Engage in regional benchmarking and include savings estimates in final rate studies.**
6. **Proposal: Include efficiencies in staffing** – There are several opportunities for staffing savings over the next few years. The average age of employees at the Corps and Reclamation is similar to that at BPA and both these organizations are expecting to see a high number of their workforce retire over the next few years. This provides an opportunity to replace this more senior workforce with new employees at lower grades and benefits. The Corps is also implementing a nation-wide program called 2012 designed to improve efficiencies within its organization, as well a performing a functional review across multiple areas and disciplines. Results from these types of programs will increase operational efficiencies in the future but it is too soon to estimate any savings in the FY 2007-2009 time period. **Draft Conclusion: Do not include a forecast of efficiencies in the initial proposal but include in the final proposal if any**

are identified.

7. **Proposal: Include funding for remote operation of projects** – Currently, the Corps is studying the possibility of remotely operating Albeni Falls and Libby from the Chief Joseph project. The initial costs of this project are for installation of the hardware and the payback comes over time. The savings are in labor dollars and occur from a reduction in the number of operators at the facilities after the project is completed. This capital project is currently assumed in the base PFR capital forecast, but because it is a capital project, any savings from eliminating the initial capital cost has essentially no effect on PFR rates. Due to the payback nature of the project, BPA recommends including this project with the forecast of savings beginning to be realized after the FY 2007-2009 rate period. **Draft Conclusion: Pursue project with negligible impact on FY 2007-2009 costs.**

In summary, BPA proposes to decrease the Corps and Reclamation FY 2007-2009 O&M expenses by $1.5M/year. This results in an average FY 2007-2009 level of Corps and Reclamation O&M expense forecast of approximately $240 M/year for the FY 2007-2009 time period. BPA does not propose any changes in the FY 2007-2009 forecasted capital spending level in the base PFR forecast which is on average $138 M/year.

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Reduce funding for WECC/NERC compliance	($1.5 M/year)

COLUMBIA GENERATING STATION PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Columbia Generation Station	$215 M/yr	See debt mgt.
FY 2007-2009 PFR Base Forecast	$284 M/yr	See debt mgt.
FY 2007-2009 Proposed PFR Forecast	**$262 M/yr**	See debt mgt.

The Columbia Generating Station (CGS) nuclear plant provides around 9% of BPA's power resources. CGS is facing many issues that will affect its costs such as mandated security levels, rapidly increasing fuel prices, aging and obsolete equipment, on site spent fuel storage, and rising employee benefit costs. Energy Northwest (EN) has recently tried to address these concerns through an industry benchmarking effort to help identify areas where efficiencies can be gained without compromising the safety and reliability of the plant. The initial results show that CGS has opportunities for substantial savings through staffing reductions and a more rigorous analysis of the need for proposed projects. These estimated savings are included in the March 2005 Draft Long Range Plan but have not been finalized or reviewed by the Energy Northwest Executive Board. Several of the areas of recommended reductions in the PFR are included in the draft Long Range Plan. The final Energy Northwest Long Range Plan Revision 1 is expected to be issued in June for Executive Board review. However, BPA must provide a CGS forecast for the initial rate case proposal as part of the PFR process before the Long Range Plan is reviewed and issued. Pending a timely review from the EN Executive Board, this forecast will be updated in the final proposal of rates.

Since the base forecasts were put together for the PFR process, there has been an increase in the market price of uranium mainly driven by a supply constraint. The PFR base forecast did not take into account these higher prices; if it had, the forecast would have increased by an average of around $5 M per year over the FY 2007-2009 period. EN is working actively to identify ways of reducing the costs of fuel, with BPA assistance. No change from the PFR base estimates is being proposed as those efforts continue.

	FY 2007	FY 2008	FY 2009
PFR Base	**$317 M**	**$248 M**	**$286 M**
PFR Base w/high market price uranium	$319 M	$255M	$293 M

The above table reflects the PFR Base changed only to reflect the current uranium market prices in line 2. No other changes were made.

Possible Decreases Identified

1. **Proposal: Include the forecast reductions proposed in the CGS long range plan** – In response to rising costs over the past years and concerns from BPA and customers, EN has recently undergone a cost competitiveness initiative as a result of benchmarking its costs of operating the facility to other like nuclear plants. Through this process, the opportunity for significant cost savings was identified that EN is now pursuing for

adoption in the FY 2007-2009 time frame. While the Long Range Plan that includes the cost competitive initiative reductions has not been finalized by EN and reviewed by its Executive Board, BPA proposes to include these O&M savings in the power initial rate proposal at an average of $22 M/year, subject to revision in the final proposal based on Board action. PFR participants supported this proposal. **Draft Conclusion: Reduce CGS O&M costs by an average of $22 million/year per draft Energy Northwest plan.**

2. **Proposal: Eliminate the license extension spending for CGS in FY 2007-2009 –** The license for CGS expires in 2023 and EN is proposing to spend approximately $8.5 M over the FY 2007-2009 period to pursue the license extension option. This process will take about 4 years and cost approximately $14 M in total. The majority of this cost is embedded in the FY 2007-2009 base PFR forecast. EN had originally started work on this project in the current rate period but chose to defer this work at least two years as a result of the cost competitive initiative. There was much discussion around this topic at the PFR workshops. Feedback so far from customers was supportive of leaving this amount in the FY 2007-2009 forecast. PFR participants also urged a public process on the ultimate decision to extend the life of the project. **Draft Conclusion: Do not eliminate CGS license extension spending.**
3. **Proposal: Forecast Energy Northwest borrowing to pay for capital items in the FY 2007-2009 period** – See Debt Management section.
4. **Proposal: Forecast Energy Northwest borrowing to pay for fuel in the FY 2007-2009 period** –See Debt Management section

The PFR Base forecast for CGS assumed that all budget items in the forecast were expense funded (no financing). Several suggestions were made in the PFR that EN should borrow for spending that is properly categorized as capital according to accounting standards. The resulting reduction in FY 2007-2009 expenses would be offset in part by an increase in debt service. Energy Northwest and BPA are continuing to review capital expenditures to identify items that are candidates for debt financing. This is addressed below in the section on debt service. Any decisions made in the debt management area about capitalizing EN items will have an impact on the forecast for EN O&M. The O&M forecast will be updated in the rate case to reflect the impacts of any decisions related to debt management.

Forecast Comparison
PFR Base and PFR Base Adjusted for Debt Financing of Capital
BPA Fiscal Years
Dollars in Millions

PFR BASE	**FY 2007**	**FY 2008**	**FY 2009**
O&M	209	183	210
Fuel	62	44	51
Capital	38	13	16
Decommissioning Fund Contributions & NEIL	8	8	8
Total	**317**	**248**	**285**
PFR Base Adjusted for Debt Financing	**FY 2007**	**FY 2008**	**FY 2009**
O&M	209	183	210
Fuel	62	44	51
Capital	0	0	2
Approximate Capital Financing Costs	3	5	8
Decommissioning Fund Contributions & NEIL	8	8	8
Total	**282**	**240**	**279**

The table above assumes that 100% of capital will be debt financed. The capital financing costs are the estimated debt service costs. It is possible that results could change when considered in the context of BPA's total debt portfolio.

Forecast Using the Energy Northwest Draft Long Range Plan
Assumes Debt Financing of Capital
BPA Fiscal Years
Dollars in Millions

	FY 2007	**FY 2008**	**FY 2009**
PFR Base	**317**	**248**	**286**
O&M Reduction	**(23)**	**(19)**	**(24)**
Reduction in O&M due to Debt Financing Capital	**(38)**	**(13)**	**(16)**
Increase due to Market Prices of Fuel	**5**	**8**	**8**
Increase in Decommissioning Trust Fund Contributions	**1**	**1**	**2**
Latest Revised Estimated Total O&M Forecast	**262**	**225**	**256**

The table above assumes that 100 % of capital will be debt financed and does not include debt service on funds borrowed for capital spending.

In summary, BPA proposes adopting the draft version of the Long Range Plan forecast and further proposes to assume debt financing for CGS capital items, though this latter decision is one made within the rate case, not the PFR. Debt financing is also subject to EN Board action.

BPA Proposals	**Proposed PFR Base FY 2007-2009 (Reductions)/Increases**
Reduce CGS O&M costs per Draft Long Range Plan	($22 M/year)

FISH & WILDLIFE PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Direct Program (Integrated Program)	$139 M/yr	$20 M/yr
FY 2007-2009 PFR Base Forecast	$139 M/yr	$36 M/yr
FY 2007-2009 Proposed PFR Forecast	**$143 M/yr**	**$36 M/yr**

BPA is committed to fulfilling its fish and wildlife obligations through managing to clearly defined performance objectives and implementing the most cost effective strategies for meeting these objectives. Fish and wildlife mitigation efforts affecting BPA power rates consist of several different components: 1) hydro operations effects (not a distinct expense line item), 2) the O&M of the Lower Snake River Compensation Plan hatchery system, 3) fish and wildlife mitigation projects funded under the Integrated Program (also known as the Direct Program or Council Program) in partnership with the Northwest Power and Conservation Council, 4) the power share of the O&M of the Corps of Engineers' fish passage facilities, its hatcheries and its juvenile salmon transportation program, 5) the power share of the O&M for the Bureau of Reclamation's Leavenworth fish hatchery complex, and 6) the debt service (depreciation, amortization, and net interest) associated with capital investments in fish passage facilities at the Corps of Engineers dams, and in hatcheries and land acquisitions under the Integrated Program. Additionally, 50% of the Council's internal operating costs are also categorized as an additional fish cost line item on BPA's Power Business Line Income Statement.

Up to this point in the PFR process, BPA has used current rate period funding levels for the capital and expense portions of the Direct or Integrated Program as placeholders. Other components reflect draft funding levels gleaned from informal discussions with the Corps, Reclamation and the US Fish and Wildlife Service. With this letter, BPA will propose new draft fish and wildlife program spending levels for the FY 2007-2009 rate period. This draft proposal reflects BPA's current thinking, as informed by six fish- and wildlife-focused PFR workshops; numerous meetings with the Council, constituents, states, Tribes, and customers; and extensive study of the factors that may tend to push costs both higher and lower in coming years.

Possible Decreases Identified

1. **Proposal: Assume proposed installation and test mode of additional Updated Proposed Action (UPA) Surface Passage Improvements and Implement Snake River Fall Chinook Transport vs. In-River Migration Study –** One of the assumptions to be made in the FY 2007-2009 time frame is the timing and installation of additional surface passage improvements, including removable spillway weirs (RSWs), on three of the hydro projects. The PFR base case assumed installation of weirs and operation of these facilities during the FY 2007-2009 rate period at Lower Granite and Ice Harbor but assumed no surface passage improvements at The Dalles, McNary, Little Goose or Lower Monumental. PFR participants supported updating cost estimates to reflect assumptions regarding the planned installation schedule for additional improvements at these three projects. Some participants believed that this would allow spill reductions with the FY 2007-2009 rate period. BPA agrees that it is appropriate to assume installation and

test mode of the UPA Surface Passage Improvements at The Dalles, McNary, and Lower Monumental. The construction costs for these facilities are funded via the Corps of Engineers' Columbia River Fish Mitigation Project annual congressional appropriation, with debt service not beginning until after the facilities are declared fully in-service (i.e., no longer in test mode).

The other F&W proposal impacting hydro operations is the implementation of the Snake River Fall Chinook Transport vs. In-River Migration Study. In the UPA/2004 BiOp there is a commitment to study the relative survival of Fall Chinook that migrate in river vs. via barge transportation. As part of this study, water that is normally used to generate electricity at the collector projects would be spilled instead, reducing generation. This assumption is not in the base PFR forecast and would tend to put upward pressure on rates. BPA heard many arguments for and against this evaluation. One concern was the timing of these studies and the installation of the RSWs listed above and its impact on the validity of the data collected. It was suggested that BPA postpone this test until after the RSWs are installed so studies can be conducted using the same operations from year to year. Others argue not to include it in the rate case initial proposal because it is costly. On the other hand, it was noted that these tests are part of the UPA/2004 BiOp and doing anything other that what is in the UPA/BiOp could endanger the BiOp. BPA intends to honor its commitment in the BiOp and plans to begin implementation of the test during the FY 2007-2009 time frame. Though the spill costs of this test were not included in the PFR base, neither were the spill reductions potentially resulting from the above-described installations of some surface passage improvements. The best current estimate is these spill cost increases and reductions will roughly cancel each other out. **Draft Conclusion: No net savings in spill costs.**

2. **Proposal: Fund the expected baseline O&M costs for the Lower Snake River Compensation Plan (LSRCP) hatcheries, plus some additional funding for high priority non-routine maintenance** – This program includes spending levels for 11 hatcheries, 10 satellite facilities, and monitoring and evaluation of fish health and hatchery program effectiveness in the Lower Snake River. BPA directly funds the expense portion of O&M only under a Direct Funding agreement that began in 2001. The base spending level in the PFR assumes funding for baseline O&M expenses as well as some non-routine maintenance; e.g., replacement pumps, motors, raceway and water line repairs. As with many of the items, there was much variation in suggestions regarding funding levels for these facilities. Some customers suggested BPA fund only the baseline level of O&M only with funding for additional needs made available only when BPA had positive net revenues. It was also argued that BPA not fund any capital items associated with these hatcheries. BPA proposes to fund LSRCP O&M costs at a level slightly lower than the initial proposed level, allowing some funding for the highest priority non-routine maintenance expense items but also taking into account the fact that historical actual O&M costs have come in under start-of-year budgets in recent years. BPA will negotiate a new direct funding agreement for the LSRCP with the U.S. Fish and Wildlife Service for FY 2007–2011 consistent with this principle. **Draft Conclusion: Reduce (LSRCP) O&M costs by $300,000 per year.**
3. **Proposal: Change Columbia River Fish Mitigation (CRFM) plant-in-service dates** – See Debt Management section.

Possible Increases Identified

4. **Proposal: Increase Integrated Program Funding Level** – The funding level for the Integrated (or Direct) Program covers numerous projects intended to meet BPA's mitigation objectives under the Northwest Power Act, as well as BPA's Endangered Species Act offsite fish and wildlife requirements under biological opinions from the U.S. Fish and Wildlife Service and NOAA Fisheries. Through the PFR process BPA has engaged interested parties in four different funding alternatives for this program. These alternatives ranged from $126 M/year to $174 M/year. Current rate period expense funding for this Program is $139 M/year, and the non-discretionary FY 2001-2004 funding level was determined to be approximately $125 M/year. As with many of the other fish related costs, the feedback was wide and varied. Some customer groups supported the lowest cost alternative, resulting in a $13 M/year reduction in spending from the current levels. Other customers proposed the low scenario but with the provision that in good water years, additional funding should be available up to an agreed upon percentage for previously-approved but unfunded projects, with provision to "bank" the money for future years if all approved projects were already funded. Other commenters suggested that funding levels remain at current levels for the next rate period, allowing time for more clearly formulated "rolling-up" and prioritization of subbasin plan driven fish and wildlife restoration efforts. The Columbia Basin Fish and Wildlife Authority (CBFWA) and others opined that even under the highest funding level, BPA would be under-funding its mitigation obligations associated with recently completed subbasin plans. CBFWA's preferred alternative advocated Integrated Program spending levels rising to $460 million annually. In the PFR, BPA proposed, and many commenters supported, that project funding be allocated such that 70% would go to on-the-ground projects (primarily hatcheries and habitat enhancement projects), 25% to research, monitoring and evaluation (RM&E), and 5% for coordination/information management and administration. The purpose of this allocation is to steer additional funding to on-the-ground projects, such as those recommended in the recently completed subbasin plans, without necessarily increasing overall funding levels. An analysis of FY 2001-2004 program funding indicated that only about 60 % of total funding went to on-the-ground work and nearly one-third of total funding went to RM&E. One commenter suggested modifying the 70/25/5 allocation guidelines, to move even more funding ($10 M) from RM&E, and to also reduce BPA's fish and wildlife overhead costs by $2 M (approximately 20 percent) and move these dollars to provide for even greater on-the-ground funding levels without increasing overall funding of this program.

   In numerous discussions with Council members, Council staff, and CBFWA members, drivers influencing future work efforts in the Integrated Program project categories of hatcheries, habitat work, RM&E and coordination were discussed. Among the drivers for increased funding are habitat restoration activities prioritized in subbasin plans and the 2004 FCRPS UPA/BiOp habitat enhancement work in the Columbia Basin tributaries. Additional drivers identified include inflation costs driven by salaries, health insurance costs and rising energy costs. However, the program's expense budget increased from $100 M/year in the FY 1997-2001 period to $139 M/year in the current period. While much of this additional funding was intended to cover increased ESA requirements, it also provided a very significant allowance for inflation. The allocation guidelines that were extensively discussed in the PFR process would provide for substantial increases in available funding for habitat enhancement work under the auspices of the subbasin plans and the new Biological Opinion by shifting some funding away from RM&E and coordination contracts. However, some commenters pointed out that there are substantial pressures from both NOAA Fisheries and the Power Council's independent science groups (ISRP and ISAB) for elaborate monitoring and evaluation efforts, making such funding shifts to on-the-ground work challenging to accomplish. Additionally, it was suggested that given the hurdles associated with reinventing the RM&E program, funding decisions on habitat restoration projects should precede RM&E project selection, so as to not create a situation where RM&E funding pressures adversely affect available funding for habitat work. Additionally, under the Northwest Power Act, BPA has funded a substantial wildlife mitigation effort to replace habitat lost by inundation effects resulting from reservoir construction and operation. In recent years, some of this mitigation has been funded using capital borrowing under BPA's borrowing authority consistent with BPA's capitalization policy. Several Integrated Program partners have expressed strong concerns about the difficult thresholds required by BPA for using capital funding to meet wildlife mitigation objectives and are frustrated with the slow pace towards meeting such objectives. Some have suggested that Integrated Program funding levels be increased so as to use additional expense funding for increasing the pace of wildlife mitigation. Others suggested that the region be more aggressive in the pace of wildlife mitigation efforts, but with active use of BPA's fish and wildlife capitalization policy as opposed to using the expense budget. To more fully utilize BPA's Fish & Wildlife capital budget over this next rate period, new focus and energy will be needed to identify and plan projects that qualify for capital assignment under BPA's capitalization policy. **Draft Conclusion: After weighing all these arguments drivers, and extensive comments in the PFR process, BPA proposes to fund the integrated program at the $143 M/year expense level and to shift roughly $15 M of FY 2001-2004 average current funding away from RM&E and RM&E-related support activities to fund additional habitat enhancement efforts, and maintain hatchery programs.**

The result of this funding shift would be that overall funding for on-the-ground work (primarily habitat improvement and hatchery O&M) would be about $15M greater than FY 2001-2004 levels, providing for both a substantial funding increase for subbasin plan- and UPA-driven habitat enhancement work, and also an allowance for inflation in the O&M for hatcheries funding under the program.

The completion of 58 subbasin plans offers the region the opportunity to refocus program implementation to target specific, high priority biological objectives that may appropriately be addressed as mitigation for the FCRPS. Additionally, the recently completed Updated Proposed Action and NOAA Fisheries Biological Opinion call for habitat improvement efforts as strategies for avoiding jeopardy to ESA-listed salmon and steelhead. The development of BPA's PISCES computer program, enabling projects to be managed and tracked from solicitation to completion, will offer the ability for projects to be managed for specific work elements, accruals to be tracked as they are invoiced, and for the region to monitor progress towards more clearly defined performance objectives. All of these factors offer the region the opportunity to use the coming rate period as one of transition to a more performance based approach. To bring about this repositioning of BPA's implementation of the program, additional work needs to be done in the following areas:

- Subbasin plans need to be "rolled up" to provincial objectives (e.g., population goals, by province, for Chinook salmon) in a manner relevant to FCRPS responsibilities.
- Recommendations to BPA for program funding need to be prioritized to show where and when different species or geographically which habitat should be the focus for the next several years.
- Performance standards also need to be developed for use in the solicitation process (e.g., physical standards (streamflow levels, river miles of blocked habitat reopened, etc) and biological standards (population levels).
- Accounting for mitigation completed to date with ratepayer funding.
- Reallocating program funding to have 70% of funding serve projects that directly benefit fish and wildlife.
- Accounting for the effects of ocean conditions on anadromous fish.
- Assessing the role in the program for the causal factors for population decline that go beyond factors associated with the FCRPS or the hydro system.
- Creating new partnerships and cost-sharing protocols for application to mitigation objectives and strategies, especially where there are shared responsibilities.
- Completion of recovery plans and assessment of BPA's responsibilities under them.
- Adhering more closely to the program's 70/15/15 funding allocation guideline for anadromous fish, resident fish, and wildlife, respectively. This allocation would include and be consistent with the principles contained in the UCUT proposal that was submitted in the fish and wildlife PFR meetings.

Many of these issues will be addressed in the next two years, through, most likely a project selection process or a Council Program Amendment process. These efforts will not be finished in time for selecting proposed program spending levels for the PFR or the rate case initial proposal. In addition, a regionally accepted methodology for looking at the current Integrated Program project portfolio and determining which discretionary projects should continue in FY 2007, which projects should no longer be funded, and which new projects should begin being funded, is still at the initial levels of a work-in-progress. After tasks mentioned above are complete, the transition will be able to move to its final stages where the current project portfolio can be more rigorously assessed for how well it meets biological and physical performance objectives in the most cost effective manner.

After much debate over funding levels for F&W, BPA proposes the following changes to the forecasted amounts in the PFR.

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Increase Integrated Program Spending Level	$4 M/year
Reduce US Fish & Wildlife Service Spending Level	($0.3 M/year)

OTHER

Throughout the PFR workshops several items where changes could occur were identified that did not fall into the major program areas examined during the PFR. Nonetheless, BPA thought it important to include these areas in the closeout report since they have an impact on rates.

1. **Proposal: Remove Spokane Settlement forecast** – Discussions have gone on for many years of providing the Spokane tribe with compensation for lost land resulting from federal dam construction, similar to the settlement BPA currently has with the Colville tribe. Congress has considered legislation creating such compensation. A placeholder for such compensation payments was included in the PFR Base. However, it is not appropriate to plan on such payments unless and until Congress has authorized them. **Draft Conclusion: Remove the forecast of Spokane Settlement costs in the rate case initial proposal FY 2007-2009 spending levels and revise it in the final proposal if it passes.**
2. **Proposal: DSI Benefits Forecast** – During the time the PFR base forecast was assembled, there was an outstanding issue of what type of benefits the DSI's would receive in the FY 2007-2009 time frame and the cost associated with them. The PFR base adopted the then proposed DSI Record of Decision (ROD) amount of $40 M/year in benefits and assumed it would be delivered in money rather than power as a placeholder. Understanding this issue is one that will be resolved in the Short Term Regional Dialogue and rate case arena, the forecast in the PFR will be updated in the rate case to reflect the decisions from the Regional Dialogue conclusions. **Draft Conclusion: This item will be updated in the rate case to reflect the outcomes from the Supplemental Regional Dialogue ROD on DSI Service.**
3. **Proposal: Reduction in Environmental Benefits Forecast** – When the PFR base forecast was put together there was a forecast of around $7 M/year for mitigation of the proposed spill reduction in FY 2004 that was accidentally carried forward from that timeframe. This should not have been included and BPA has since made this correction and has included it in the forecast accompanying this letter in the "other" category. **Draft Conclusion: Update Environmental Benefits forecast in closeout report.**
4. **Proposal: Adopt Conditional Budgeting** – An idea brought up at the PFR workshops was to link BPA spending levels to its financial performance every year. When BPA faced a year where financial results fell below assumptions in the rate case then spending levels would be reduced to help offset some of the losses. On the other hand, when BPA had a good financial year the spending levels could be increased to make up some of the projects that were put off in the low water years. This would reduce the need for risk mitigation costs in the rate case and that BPA spending would bear some of the burden in poor financial years. BPA's employee award program, for example, already has this variability built into it. Given the magnitude of the risk management challenge in this next rate period, BPA considered this concept carefully. However, three concerns make BPA reluctant to pursue this concept at this time: First, it appears doubtful that enough of the budget can be put "on the margin" in this way to make a significant impact on risk mitigation costs, without jeopardizing essential functions. Second, constructing and implementing such a construct could add significant complexity. BPA is reluctant to add complexity unless risk management benefits are significant. Third, it is not clear how this concept could be implemented without making program cost levels a rate case issue –

a step BPA does not wish to take. **Draft Conclusion: Do not pursue conditional budgeting.**

BPA Proposals	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Remove Spokane Settlement Amount	($6 M/year)
Update Environmental Benefits forecast	($7 M/year)

DEBT MANAGEMENT

	Average Expense	Average Capital
FY 2002-2006 Debt Management	$892 M/yr	N/A
FY 2007-2009 PFR Base Forecast	$1,003 M/yr	N/A
FY 2007-2009 Estimated PFR Forecast	**$965 M/yr**	**N/A**

Unlike many of the programs studied and discussed in the PFR process, the debt management area is not a program but a result of the capital investments the agency has made over time, forecasts for future capital investment, and BPA's debt management decisions. The PFR included discussion on these items because it was important for participants to understand the implications of past debt management decisions and proposed capital spending levels. But how BPA includes decisions and assumptions on debt management are rate case issues and will be discussed in that forum. With that said, the PFR process brought attention to many issues associated with program funding proposals. BPA's current thoughts are described under each topic below.

Possible Decreases/Increases Identified

1. **Proposal: Change Columbia River Fish Mitigation (CRFM) mitigation analysis plant-in-service schedule** – The Corps receives appropriated funds for the CRFM project to mitigate impacts to anadromous fish passage of construction of the Columbia/Snake River dams. Currently there is approximately $300 M of mitigation analysis being held in "construction work in progress" related to alternative analysis, prototype development and other studies done under this program. The Corps is currently evaluating to determine the appropriate schedule for putting this amount into "plant in service", at which time it will become BPA's obligation to repay the power share. The Corps has provided two different "bookend" scenarios (A&B). Many customers have expressed a preference for scenario B to avoid having additional costs hit the FY 2007-2009 rates. It is ultimately not BPA's decision when to put this amount into service. However, if the Corps has not made a decision at the time BPA prepares its rate case initial proposal, BPA will decide what assumption to include in its rate case initial proposal. This forecast may be updated to reflect the Corps decision prior to the final rate proposal. **Draft Conclusion: At this time, BPA prefers the Corps use scenario B.**
2. **Proposal: Debt finance CGS capital projects with final maturity of FY 2018** – Typically, EN includes capital expenditures in its O&M projections and they are revenue financed through BPA rates. In the SN CRAC rate case, BPA and EN agreed to finance CGS capital items that qualified under GAAP for capital for the FY 2004-2006 period. As we head into the next rate period it has been suggested in the PFR that we continue this practice of financing capital items through debt rather than revenue financing. **Draft Conclusion: Though the PFR is not the process for this decision, BPA is leaning toward assuming debt financing for CGS items that qualify under the capitalization policy and limit the final maturity to FY 2018.**
3. **Proposal: Finance Nuclear Fuel** – The cost of fuel has always been treated as an expense through BPA rates and that assumption is continued in the base PFR forecast.

Some PFR participants argued for capitalizing fuel to help spread the costs over time. EN generally purchases roughly the same amount of fuel as is burned by CGS each year. Under these circumstances, borrowing to pay for fuel costs is similar to borrowing to pay O&M costs. However, if fuel for several years of CGS operation is purchased in one year, financing such "lumpy" fuel costs can make sense as a means of spreading the costs to the years in which the fuel is actually burned. **Draft Conclusion: No assumption of fuel cost financing until EN develops its strategy for managing the recent run-up in nuclear fuel costs and changes its policy of not financing fuel generally. Final decisions on these topics will be made in the rate case.**

4. **Proposal: Change the amortization period for Conservation investments** – In the FY 2002-2006 rate case it was determined that conservation augmentation investments should be amortized over the term of the existing contracts, i.e., through FY 2011. The decision was made on the basis that these conservation augmentation investments had benefits that were only certain to accrue for as long as the contracts were in place. This decision has created concern among the customers because in the last few years of the contract period any new conservation investments are essentially expensed under this treatment. BPA examined the current practice against 5 and 15-year recovery periods and agrees that retaining the current policy of recovering all conservation costs by FY 2011 is too conservative. However at present there are unresolved issues about how conservation costs will be recovered in a likely tiered rate structure post-2011. Until this is resolved, a relatively short recovery period appears more prudent. In addition, preliminary repayment model analysis indicated only a small reduction in debt service resulting from the longer recovery period. **Draft Conclusion: Rather than the 10-year declining amortization period policy in place for the currently operating Conservation Augmentation program, for conservation acquisition activities planned to commence in FY 2007 BPA is leaning towards establishing a 5-year Straight Line amortization period policy.**
5. **Proposal: Utilize a revised interest rate forecast for the rate case initial proposal** – This is a standard practice in the power rate cases when circumstances warrant an updated forecast and will continue to be this rate case. The interest rate forecast used for the PFR Base is not significantly different from current forecasts. **Draft Conclusion: BPA will review its interest rate forecast in the rate case and update it if needed.**
6. **Proposal: Include interest income on cash balances from the Bonneville Fund** – this is a standard practice in the power rate cases and will continue to be this rate case. The PFR is not a place where this decision is made, but because its base forecast did not include this assumption it needed to be noted. This amount will be greatly influenced by the rate structure adopted in the rate case. A rough estimate of the additional interest income is around $10 million per year. **Draft Conclusion: BPA will include interest income on cash balances in the initial rate proposal.**
7. **Proposal: Extend some of the current CGS debt beyond FY 2018 –** the current practice is not to place any debt past FY 2018 when refinancing debt in support of the debt optimization program. This is in compliance with the EN Board policy, BPA will analyze the effects on ratepayers of implementing this suggestion and share its results with the EN Executive Board over the ensuing months. **Draft Conclusion: BPA will not include this suggestion in the rate case initial proposal, but could potentially include it in final rate studies depending on the outcome of discussion with the EN Board.**

8. **Proposal: Lengthen the amortization period for F&W capital –** BPA's long-standing policy is to amortize BPA's F&W capital projects over a 15-year life. In comparison, any fish-related capital investments made at the dams are depreciated, with the rest of the project assets, over 75 years and repaid over 50 years. During the PFR process, several customers argued that the BPA F&W amortization criteria are too stringent and that the amortization period should be lengthened. This is a rate case issue. However, at this time BPA believes it is appropriate to continue with its existing policy, given that BPA's F&W investments are non-revenue producing assets, not attached to revenue-producing assets (as the Corps investments are), and are not owned by BPA. A change in accounting policy to allow more capital spending for assets only allowed to be capitalized under Financial Standards Board Statement #71 does not seem to be prudent, given BPA's limited borrowing authority. **Draft Conclusion: It is not appropriate to change the F&W amortization policy.**

Many of the decisions associated with the debt components of the power rates are appropriately debated in the rate case forum. But BPA thought it important to show in the PFR the impact of past and future debt management decisions since these impact power rates. This PFR close-out letter is not making any decisions associated with the debt management issues but instead is intended to portray BPA's current thinking on these issues heading into the FY 2007-2009 rate case. The savings associated with individual items are current estimates of the incremental revenue requirement impacts of each action. They are indicative of what we would expect, but when several actions are taken together the results are not necessarily additive. In other words, the total savings may well differ when the items are combined in repayment studies.

BPA's Current Thinking	Proposed PFR Base FY 2007-2009 (Reductions)/Increases
Debt Finance CGS Capital	($13 M/year)
Adopt different CRFM schedule	($5 M/year)
Change Conservation Amortization Schedule to 5 years	($ 10 M/year)
Include Interest Income on cash balances from BPA fund	($ 10 M/year)

RISK MITIGATION

The PFR looks at the costs associated with the PBL and provides an opportunity for public comment on those costs prior to them being included in the rate case. While the topic of risk mitigation is not a PFR topic it will be a major component of BPA's power rates in FY 2007-2009. Therefore, participants voiced concern that they needed to get a sense of the total picture in order to provide meaningful input into the PBL cost structure. In addition, BPA realized that risk mitigation will be a big issue in the FY 2007-2009 power rate case and wanted to begin discussions about different ways to mitigate risks. As a result, BPA included risk mitigation workshops in the PFR process with the understanding that any numbers used were preliminary and will be updated in the rate case itself. This first Risk workshop was really the beginning of FY 2007-2009 rate case workshops.

Risk mitigation will be a key topic in the next rate period because risk management is a greater challenge than in prior rate cases. Several factors are driving this amount to unprecedented levels. Gas prices have been at a historic high over the last few years. These gas prices are putting upward pressure on the electric power market prices. With the higher market prices also comes more volatility (risk) – not only does the volatility of prices for electricity increase, but the financial impact of hydro uncertainty increases, since each incremental or decremental MW of generation is worth more. This tends to increase the revenues from secondary sales but also causes greater swings in revenues when the market or hydro supply changes. Because secondary revenue uncertainty is one of the largest components of BPA's risk, the approach taken to manage it will have a large impact on the level of the FY 2007-2009 power rate, or its volatility, or both. BPA has customarily relied on financial reserves, which serve as a cushion to help manage the volatility of secondary revenues. Although the level of reserves that will be available for mitigating secondary revenue risk and other risks in FY 2007-2009 is still very uncertain, the expected value of these reserves is only $180 M going into FY 2007 (as of March 2005). That level is insufficient to manage the range of secondary market swings possible with the sustained high gas prices the markets are forecasting.

Key criteria BPA is seeking to meet in a risk management approach include meeting the established 3-year Treasury Payment Probability (TPP) standard of 92.6%, increasing PBL Minimum Liquidity Reserves to $100 M , and using only PBL reserves, revenues and risks in calculating the TPP except when the Administrator can forecast having additional reserves temporarily available. To meet these standards and cover the volatility, BPA's preliminary forecast shows it would need an additional $500 M/year in rates in order to set a flat, fixed rate without any adjustments during the rate period. This would lead to unacceptably high rates. On the other hand, if the volatility in secondary revenues could be covered by an adjustable rate, the need for large reserves could be significantly reduced, and the overall power rate could also be reduced. BPA did not propose a particular approach to risk management in the PFR but instead laid out a variety of options available to help mitigate risk and bring down the rate impact of risk management.

Though the regional discussion of this topic is just starting, some key views expressed by one or more customers to date are:

- Some customers have indicated a willingness to have an adjustable rate, if it results in a lower "effective" rate.
- Several customers have said they are much more comfortable with adjustment mechanisms that are automatic, clearly defined, and based on factors beyond BPA's control.
- Treat the variability of IOU benefits as a hedge against the variability of secondary revenues.
- Do not return to the established TPP standard for the FY 2007-2009 period, or do so on a phased-in basis.
- Review the need for an increase in minimum liquidity reserve, and/or phase-in this increase.
- In calculating TPP, recognize the availability of TBL reserves.
- Stepped rates
- Other cash management tools.

It is premature for BPA to respond to these comments now, since the regional discussion of risk management in BPA power rates is ongoing. BPA will work closely with its customers and others to find the best risk management approach from among the many candidates.

Draft Closeout Report Proposals for FY 2007-2009 Spending Levels

	EXPENSE	CAPITAL
BPA's PFR Proposals	**Proposed PFR FY 2007-2009 Average (Reductions)/ Increases**	**Proposed PFR FY 2007-2009 Average (Reductions)/ Increases**
PFR Decision Areas		
Remove Telemetering Costs from Transmission Forecast	($0.8 M/year)	
Reduce Conservation Expense Forecast	($1 M/year)	
Reduce Conservation Capital Spending Forecast		($4 M/year)
Remove forecast of Calpine from FY 2007-2008 in Renewables Forecast ($11 M/year for FY 2007-2008)	($7 M/year)	
Include facilitation forecast for FY 2007-2008 in Renewables Forecast ($5.5 M FY 2007, $11 M FY2008)	$6 M/year	
Include renewable rate credit in Renewables Forecast	$6 M/year	
Include TCI cost to Internal Operations Charged To Power Forecast	$1.3 M/year	
Include efficiencies forecast for Internal Operations Charged To Power Forecast	($8 M/year)	
Include reduced funding for WECC/NERC compliance in Corps/Reclamation Forecast	($1.5 M/year)	
Reduce O&M costs per Draft Long Range Plan in CGS Forecast	($22 M/year)	
Increase Integrated Program Forecast for F&W	$4 M/year	
Reduce US Fish & Wildlife Service Spending Level	($0.3 M/year)	
Included forecast updates for Environmental Requirements, Transmission 3rd Party GTA Wheeling and misc.	($13 M/yr)	
Remove Spokane Settlement Amount in Forecast	($6 M/year)	
Subtotal PFR Decision (Reductions)/Increases	**($42 M/year)**	**($4 M/year)**
Rate Case Decision Areas		
Debt Finance CGS Capital (net reduction)	($13 M/year)	
Adopt different CRFM schedule	($5 M/year)	
Change Conservation Amortization Schedule to 5 years	($10 M/year)	
Include Interest Income on cash balances from BPA fund	($10 M/year)	
Subtotal Est. Debt Management Reductions	**($38 M/year)**	
Grand Total	**($80 M/year)**	

Summary Table Incorporated Into BPA's Financials for PFR Draft Report:

		FY 2002-2006 Average Expense	FY 2002-2006 Average Capital	PFR Base FY 2007-2009 Average	PFR Base FY 2007-2009 Average Capital	PFR Draft Closeout letter Average Expense	PFR Draft Closeout Average Capital	Proposed PFR Delta Expense	Proposed PFR Delta Capital
1	Long-Term Generating Projects	$ 28	$ -	$ 25	$ -	$ 25	$ -	$ -	$ -
2	Renewables Program (Expense Only) Removed Geothermal forecast FY07-08 - ($7 M/yr) Add facilitation budget FY07-08 - $6 M/yr Add renewable rate credit FY07-09 - $6 M/yr	$ 22	$ -	$ 56	$ -	$ 61	$ -	$ 5	$ -
3	Conservation Program (Expense Only) Reduced Capital Forecast - ($4 M/yr) Reduced Expense Foreast - ($1 M/yr)	$ 66	$ 27	$ 71	$ 32	$ 70	$ 28	$ (1)	$ (4)
4	Internal Operations Charged to Power Rates Included forecast for Process Improvements - ($8 M/yr) Included TCI forecast - $1.3 M/yr	$ 107	$ -	$ 116	$ -	$ 110	$ -	$ (6)	$ -
5	Other Removed Spokane Settlement Forecast - ($6 M/yr) Updated Environmental Benefits Forecast - ($7 M/yr) Reduced US Fisheris Forecast - ($300 K/yr) Misc. Updates - ($1 M/yr)	$ 83	$ -	$ 120	$ -	$ 105	$ -	$ (15)	$ -
6	Fish & Wildlife Direct Program (Integrated Program) Increased Integrated Program Forecast - $5 M/yr	$ 139	$ 20	$ 139	$ 36	$ 143	$ 36	$ 4	$ -
7	Transmission Purchases, and Reserve/Ancillary Services Removed Telemetering Forecast - ($800 K/yr) Updated 3rd Party GTA Wheeling Forecast - ($4 M/yr)	$ 171	$ -	$ 189	$ -	$ 184	$ -	$ (5)	$ -
8	Settlement Payments to Residential & Small Farm Consumers of IOUs 1/	$ 375	$ -	$ 323	$ -	$ 323	$ -	$ -	$ -
9	Corps and Reclamation O&M for Hydro Projects Reduced WECC/NERC complicance forecast - ($1.5 M/yr)	$ 196	$ 110	$ 242	$ 138	$ 240	$ 138	$ (2)	$ -
10	Columbia Generating Station O&M for Nuclear Plant Reduced O&M forecast per Draft Long Range Plan - ($22 M/yr)	$ 215	N/A	$ 284	$ -	$ 262	$ -	$ (22)	$ -
11	Debt Management Debt Finance CGS Capital - ($13 M/yr) 2/ Adopt different CRFM schedule ($5 M/yr) Change Conservation Augmentation Schedule to 5 years - ($10 M/yr)	$ 892	$ -	$ 1,003	$ -	$ 965	$ -	$ (38)	$ -
12	Power Purchases	$ 559	$ -	$ 107	$ -	$ 107	$ -	$ -	$ -
13	**Total**	**$ 2,853**	**$ 157**	**$ 2,674**	**$ 206**	**$ 2,594**	**$ 202**	**$ (80)**	**$ (4)**

1/ Total includes 900 aMW of Monetary Benefit ($139 M/yr average), and approximately 618 aMW of load augmentation (BPA power buybuck) ($235 M/yr average)
2/ Total includes net impact of CGS capital decision. Final rate case outcome will show a reduction in CGS O&M and an increase in Debt Management.

BPA's Financial Disclosure Information

* All FY 2005-2009 information cannot be found in BPA-approved Agency Financial Information but is provided for discussion or exploratory purposes only as projections of program activity levels, etc.

* All FY 1997-2004 information is consistent with audited actuals that contain BPA-approved Agency Financial Information.