

summer of 2000, PBL's proposed cost-based rates for FY 2002–2006 would be far more attractive to customers than market alternatives, and, in fact, public utility customers requested purchase contracts for significantly more power than forecasted in the BPA's May 2000 final rate proposal. This resulted in total load obligations of about 3,200 aMW more than the existing system could supply.

After a public comment period, BPA notified rate case parties on October 6, 2000, that it intended to initiate a limited 7(i) proceeding to address increased load obligations and high market prices. On December 1, 2000, BPA announced its proposed amendments to the 2002 wholesale power rate adjustment proposal. *Proposed Amendments to 2002 Wholesale Power Rate Adjustment Proposal*, 65 FR 75272 (2000) (Amended Proposal). BPA filed an Amended Proposal rather than formally modifying the original rate proposal for two main reasons. First, rates needed to be in place by October 2001 and there was no assurance a full rate proceeding could have been conducted within the time remaining. Second, the Treasury payment analysis showed that secondary revenues, even with very conservative assumptions relative to the actual forward market, would very likely cover any cost overruns.

After BPA released its Amended Proposal, the forecast for starting rate period reserves dropped substantially. In addition, market prices rose significantly from BPA's December 2000 forecast. These rapid developments necessitated significant changes to the Amended Proposal. BPA began settlement discussions with rate case parties to attempt to forge a resolution to the matter. When BPA and many of the rate case parties reached a Partial Settlement Agreement, BPA filed a Supplemental Proposal reflecting the terms of the Partial Settlement Agreement. The Partial Settlement Agreement included three separate Cost Recovery Adjustment Clauses, allowing the adoption of a general approach to keep base rates low and deal with financial shortfalls though the CRACs rather than raise base rates. These tools gave BPA the risk mitigation necessary to have a sufficiently high Treasury Payment Probability (TPP). The three CRACs are the Load-Based (LB) CRAC which is designed to cover augmentation costs, the Financial-Based (FB) CRAC which is designed to cover net revenue, and the Safety-Net (SN) CRAC which is available if the likelihood of missing a Treasury payment or payment to any other

creditor is 50 percent or greater despite the implementation of the LB and FB CRACs. On September 28, 2001, FERC granted interim approval of BPA's rate filing, *U.S. Department of Energy—Bonneville Power Admin.*, 96 FERC ¶ 61,360 (2001).

The forecasts included in the Supplemental Rate Proposal, and reflected in the TPP forecast, included two sources of revenue that would cover expense increases. The first revenue source was secondary sales from high market prices. Market prices were forecast to stay high through 2003 because the development of electrical infrastructure was expected to take up to two years of development to catch up with the high demand that BPA and the west coast was experiencing. Therefore, the initial two years of the rate period were expected to be supply-limited. The second revenue source was also tied to these high market prices. Credits toward BPA's Treasury payments based on fish-related costs (fish credits) and impacts on operations were expected to contribute significantly to total revenues through high market prices. These fish credits contribute to BPA's overall revenues through a credit against BPA's payment to the U.S. Treasury. When market prices are higher, the size of the credit available to BPA may increase. BPA's June 2001 forecasts for secondary energy prices and available credits during the rate period proved to be inaccurate when market prices dropped faster and to lower levels than forecasted. This resulted in lower-than-forecasted revenues for BPA in fiscal year 2002. Hydro production during FY 2002–2003 also has been well below forecasts. The lingering effects of the 2001 drought on FY 2002 and the poor hydro conditions in 2003 have contributed to the significant decline in BPA's revenues. Although the hydro conditions appeared to be about normal over the January-July 2002 period, BPA stored a significant amount of water to replenish the low reservoirs resulting from the 2001 drought. This need for storage resulted in less 2002 hydro production than was forecast.

In addition, both operating and non-operating cost increases, relative to the levels assumed in the rates that BPA filed with FERC, have contributed to BPA's eroding financial condition. These increases include: BPA internal operating costs; hydro system costs; Federal debt service, net interest expense and depreciation; Columbia Generating Station costs; Direct Service Industries, California Independent System Operator and California Power Exchange bad debt expenses; conservation costs; and an increase in

benefits to residential and small farm customers of investor-owned utilities.

Faced with a deterioration of its overall financial condition, BPA sent a letter to rate case parties and other interested entities in the region on July 2, 2002, announcing the beginning of the Financial Choices public comment process. The Financial Choices process examined a variety of financial and program options for addressing PBL's FY 2003–2006 financial challenges. In this process, BPA described those financial challenges, the actions BPA already had taken to address the problem, and the financial outlook for the remainder of the rate period. Additionally, BPA identified a variety of potential financial alternatives that, separately or in combination, could form the basis of a solution to PBL's financial situation.

During the course of the process, BPA held ten public meetings and workshops with customers, public interest groups, tribes, and other interested persons to explain the nature of the problem, and to show program level costs and the potential effects of cost reductions. BPA also solicited suggestions to address its growing financial problem. The public comment period closed on September 30, 2002. As a result of the Financial Choices process, BPA made decisions to cut, eliminate, or defer certain costs and expenses. BPA issued a Financial Choices close-out letter to the region on November 22, 2002, outlining BPA's plan, in part, for meeting the PBL's financial challenges. The plan takes into consideration extensive public input BPA received during the Financial Choices public process. The actions BPA has taken, and will take, as described in the Financial Choices close-out letter, include the identification of \$350 million in expense savings, expense deferrals, and other actions for the FY 2003–2006 period. These will be reflected in the program levels in BPA's Initial Proposal. An additional \$500 million of other potential savings and deferrals are being pursued, but are uncertain since they largely involve actions by other parties in the region.

While BPA did not trigger the SN CRAC in November, by January 2003, worsening water conditions and a refined secondary revenue forecast increased the net revenue gap for the 2002–2006 rate period to \$950 million. In February 2003, the Administrator determined that BPA had lower than a 50 percent probability of making its Treasury payment in September 2003. An SN CRAC adjustment became necessary to ensure that rates and revenues will be sufficient to recover