

BONNEVILLE POWER ADMINISTRATION
BUSINESS PLAN 1995

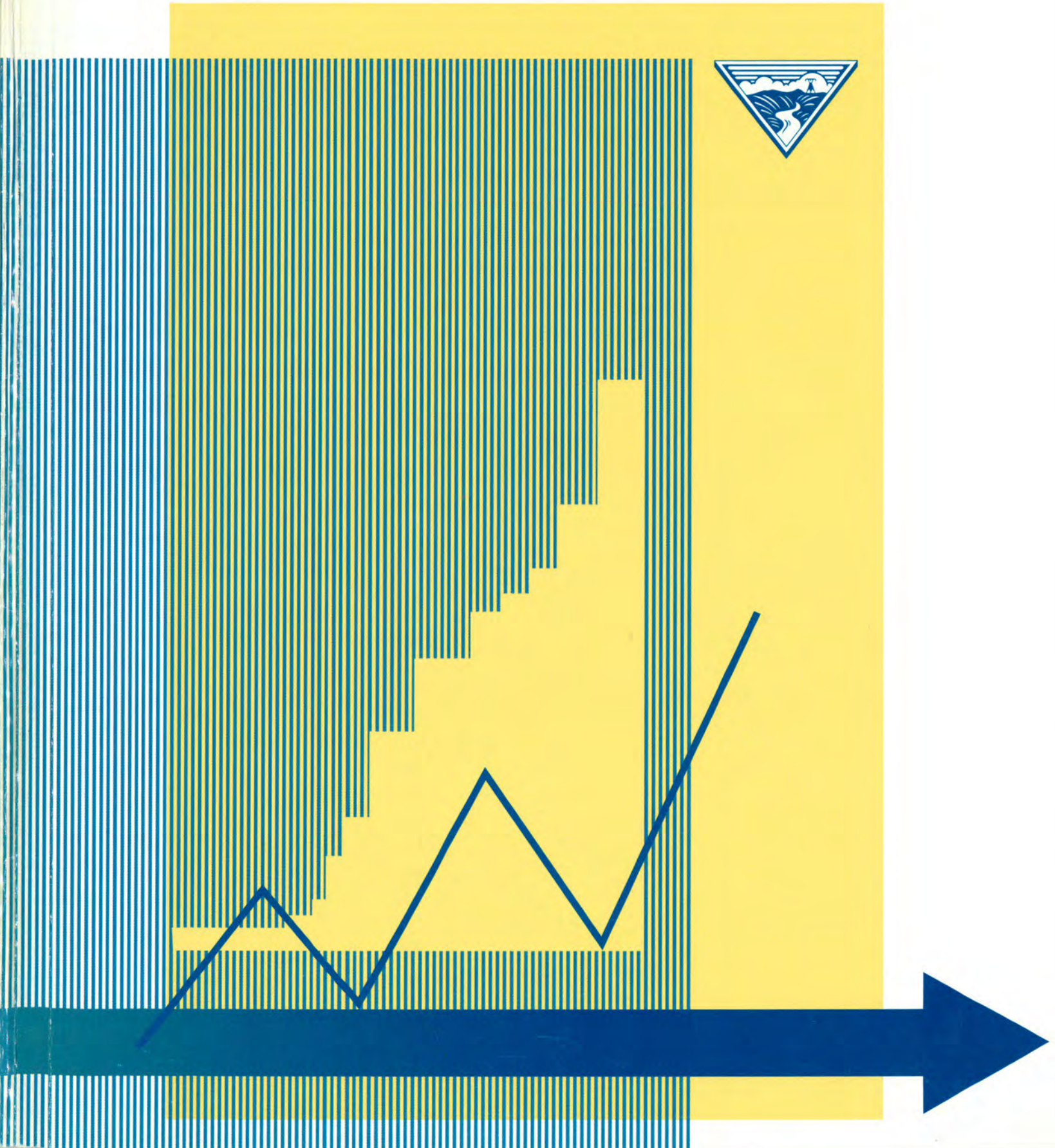


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BPA's Strategic Mission

BPA provides electric power, transmission, and energy services in increasingly competitive markets. Our success in the marketplace supports the achievement of our vital responsibilities for fish and wildlife, energy conservation, renewable resources, and low-cost power for the people of the Pacific Northwest. We succeed by satisfying our customers and enhancing the economic and environmental health of the region.

We will remain the least-cost producer and a creative and flexible marketer in the region. Our success will help ensure economically strong Pacific Northwest communities.

We value the individual diversity, entrepreneurial spirit, personal responsibility, and public service of our fellow workers. We welcome new ideas and are accessible to the citizens of the Pacific Northwest.

BPA has developed this Business Plan through many months of planning, information gathering and discussions within BPA and with outside parties. One important element of the process was the Business Plan Environmental Impact Statement (EIS), which described the alternative directions available to BPA and their impacts. The public was invited to comment on the Draft Business Plan and Draft Business Plan EIS (issued together in June 1994), and on the Supplemental Draft Business Plan EIS (issued in March 1995). Written comments and discussions at public meetings helped BPA to improve its plans to better meet customers' and stakeholders' concerns.

Throughout this process, the market and BPA's operating environment have continued to change rapidly, and BPA has continued to adapt its plans to new circumstances. During the same period, renegotiation of power sales contracts, the development of transmission principles, rate development processes, and other discussions, such as those related to fish and wildlife and energy conservation, have generated intensive dialogue with customers and stakeholders about BPA's proposals. These led to additional refinements in BPA's plans to keep pace with the changing market.

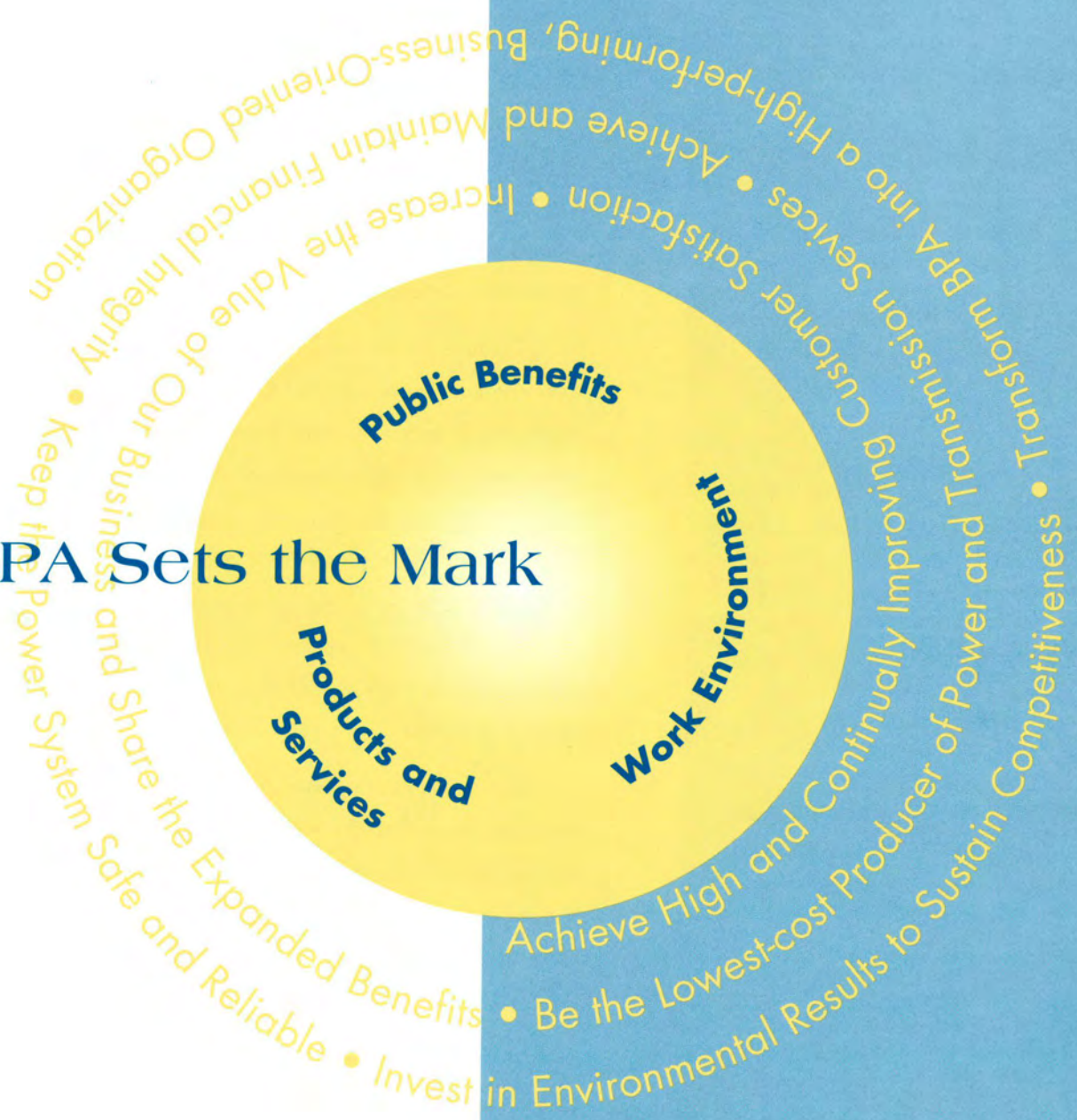
All of this information has contributed to BPA's choice of direction as set forth in this plan. BPA's decision to adopt a market-driven approach to achieve its missions is documented in the Record of Decision on the Business Plan Environmental Impact Statement.

Clearly, changes in the market will continue. A business plan cannot be effective if it is a static and unchanging document. If new circumstances lead to fundamental changes in BPA's plans, this Business Plan will be updated. BPA will continue to discuss its plans and its role in the regional electric energy market with all interested customers and stakeholders as the future unfolds.



Introduction

BPA Sets the Mark



The Bonneville Power Administration can't predict the future, but it can anticipate and prepare for it. Historically, BPA's great strength has been its ability to adapt to change. As BPA approaches the 21st century, it faces more external changes than at any time in its history. It is entering a new era defined by intense competition, deregulation of wholesale power marketing, utility industry restructuring, fish-oriented hydro operations and a changing federal role. This Business Plan is BPA's road map to the 21st century. It lays out the broad strategic direction BPA is taking as it moves toward the future, and it describes the objectives and the policy decisions designed to meet those objectives. Following the guidance of its strategic business objectives, BPA will create a supportive **work environment** that will generate better **products and services** so that BPA's business success can increase the **public benefits** that BPA provides to the region.

I. A Vision for the 21st Century

BPA is positioning itself to have the speed, flexibility and responsiveness to take advantage of whatever future is in store for the electric utility industry. This agency intends to be a strong and successful player in a competitive marketplace, in order to excel in fulfilling its missions to serve the people of the Pacific Northwest.

To the extent it can shape that future, BPA will be an industry leader. To the extent that conditions are outside its control, BPA will position itself to take advantage of opportunities. To do so, BPA is taking steps that will increase its ability to respond quickly. Thanks to the Competitiveness Project, now in its third year, BPA is well on its way to transforming itself from a traditional bureaucracy into a streamlined, efficient, market-driven federal enterprise.

BPA's vision is to stabilize and then expand its position in the wholesale electricity market with competitive pricing, superior and versatile products and services, and excellent customer service. BPA will continue to provide a safe, economic and reliable transmission system and will take a leadership role to promote competitive power markets through open and comparable transmission access. BPA will become a major supplier of energy services for utilities and their retail consumers.

In the short term, BPA is vigorously transforming itself to engage and thrive in the first significant competition it has faced in its history. In the long term, as the market shakes out, BPA will remain the benchmark for providing low-cost power.

Satisfied customers enable BPA to succeed as a federal enterprise in the marketplace, which will enhance BPA's ability to fulfill its public missions for the Pacific Northwest.

BPA's vision of success begins with a satisfied and diverse customer base. Satisfied customers enable BPA to succeed as a federal enterprise in the marketplace. This in turn will enhance BPA's ability to fulfill its public missions for the Pacific Northwest. Changes in the way BPA fulfills its public missions will further enhance customer and stakeholder satisfaction. For example, BPA's vision of success calls for:

Fish and wildlife: A robust program that produces results with stable and predictable multi-year budgets.

Energy conservation: An efficient, decentralized program with BPA acting as the catalyst for regional conservation acquisition through its leadership in market transformation and energy services to customers.

Renewable resources: Leadership in promoting renewable resources through development and support of a green power product which BPA would provide to customers at cost.

Achieving customer satisfaction is a driving force throughout this Business Plan. BPA's success in the market is inextricably linked with meeting its public objectives. Business success will support the substantial public benefits BPA provides to the region, improving the environment and the economy. These in turn should further increase customer satisfaction.

Short-term and Long-term Outlooks

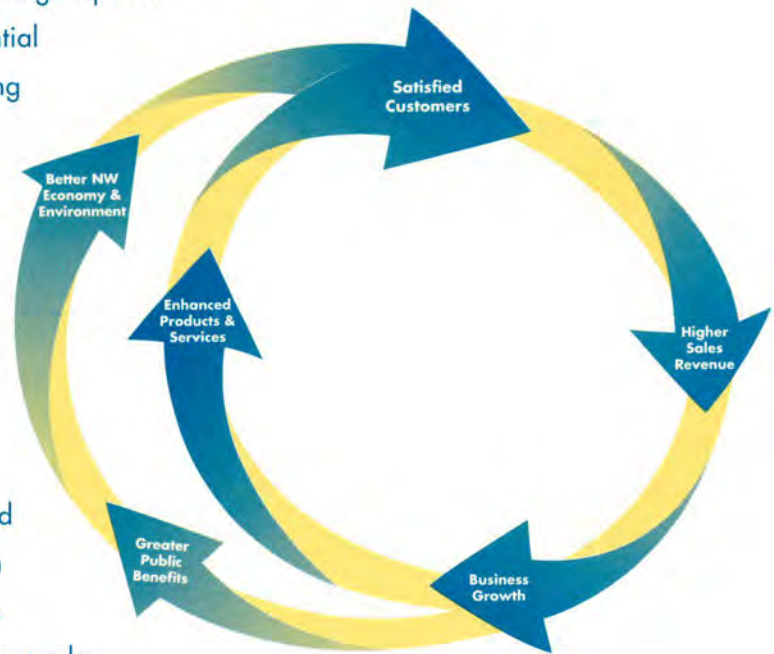
BPA is taking both a short-term and long-term look at its future. In the short term, BPA is focusing on strengthening its marketing function and stabilizing its pricing to enable the agency to be an active and successful competitor in a highly volatile marketplace. This volatility, normal in a period of deregulation, is due in part to new and aggressive players moving into the wholesale electric marketplace. Some appear willing to take sizable short-term losses to get a foothold in the market. All must trim their profit margins in the short term to compete. BPA expects some loss of its traditional sales during this period.

If historical trends from the deregulation of other industries bear out, many of the new market entrants will not survive beyond the transition period. Pricing wars will have their casualties as some players overextend themselves. The pool of low-cost resources, although extensive, is finite. As the market sorts itself out, a narrower and stronger field of competitors will emerge.

BPA will be there in the long term setting the benchmark with its overall cost-based pricing.

BPA's longer-term agenda is to replace anticipated load loss with sales in new markets and with a more diversified customer base. New business lines and sales of energy services will expand until they provide a substantial share of BPA's revenues. BPA also expects to engage in more joint ventures and partnerships to take advantage of marketing opportunities that are in the interests of the region and customers. These actions will increase BPA's revenue stability.

Also, in the longer term, BPA expects that the electric utility industry will move toward functional separation between generation and transmission. The question isn't whether it will



happen, but how far and how fast it will go. BPA is open to all the options that maintain the integrity, safety and reliability of the interconnected power grid.

BPA Fulfills a Unique Mission

As BPA positions itself to compete in a new electric power industry, a question has emerged about whether that stance is consistent with a federal role. At the same time, the role of government is changing. There are increasing demands for greater effectiveness and a sharper focus on results. By improving its efficiency and its competitiveness, BPA can continue to serve and support the people of the region.

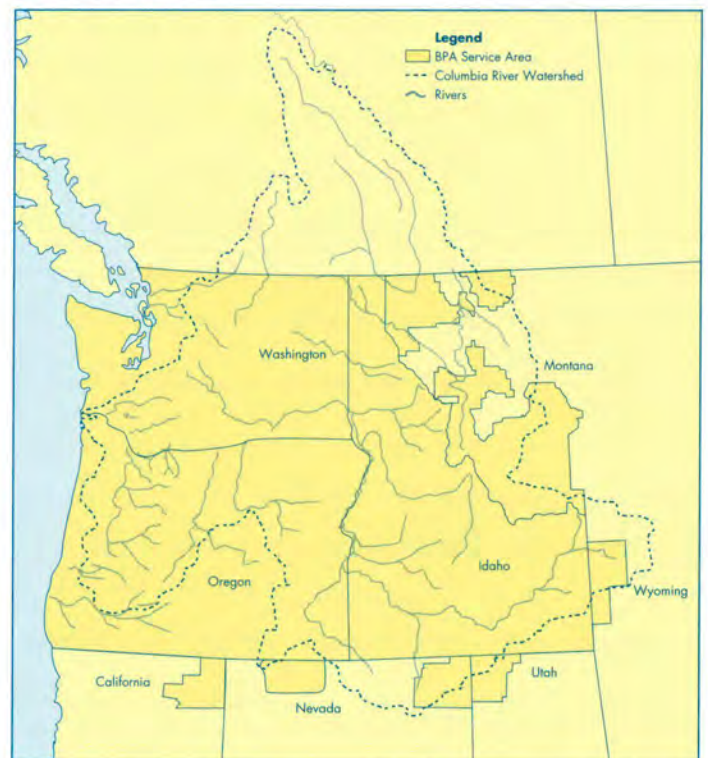
BPA has always been a federal enterprise, providing unique benefits to the Pacific Northwest and to the nation through its commercial enterprise — marketing the output of federal dams in the region. As a federal enterprise, BPA has three fundamental roles to play in fulfilling its missions.

▲ BPA is the steward of vital regional assets.

BPA is guardian, in concert with the Corps of Engineers and Bureau of Reclamation, of an international river, representing Northwest and U.S. interests. The Columbia River and its tributaries are an enormous natural resource that traverses national, tribal and state boundaries. Used carefully, this river system can simultaneously support the region's economic engine, the economic and spiritual treasure of salmon, and the nation's leading renewable hydroelectric resource. As a regionally focused federal entity, BPA is in the best position to maximize and balance the environmental and economic benefits of this hydro system.

In addition, BPA has built and operates 80 percent of the region's

BPA Service Area





high-voltage transmission system. This system is the highway for the electric power market and provides the foundation for competition in the electric utility industry.

BPA ensures that the dividends of these resources are widely available in the region. It can use its unique position to leverage and maximize the potential of the Columbia system through its coordination, neutrality and ability to forge partnerships.

▲ BPA provides public benefits in an open forum.

BPA has unique and diverse public missions ranging from providing low-cost power to protection of fish and wildlife resources. The benefits BPA produces are distributed to all corners of the region. BPA decisions are made in public forums, giving customers and constituents access to planning and decision-making not available in private enterprises. Among the region's



utilities, only BPA is responsive and accountable to the entire region, rather than to limited interests.

As a self-supporting agency, BPA provides its benefits without making demands on taxpayers for appropriations. By making regular payments, with interest, on U.S. Treasury loans, BPA guarantees a return of the taxpayers' investment.

▲ BPA's overriding goal is performance.

Given its history, expertise and resources, BPA is the best at what it does. It sets the industry benchmark for safety and reliability, and sets international standards of technical excellence. Because BPA's revenues are limited by law to its overall costs, BPA plays a singular long-term role in holding prices down.

As a federal enterprise, BPA also has a unique long-term view and can underwrite large scale projects (such as high voltage transmission) that provide lasting benefits to future generations. Research, development and demonstration projects can bring about advances in technology or commercial application that could fundamentally change the industry.

As the market stabilizes, particularly when the nuclear investment is paid off, BPA will remain the benchmark for power and transmission prices, giving ratepayers the best long-term assurance of low-cost power in the Northwest.



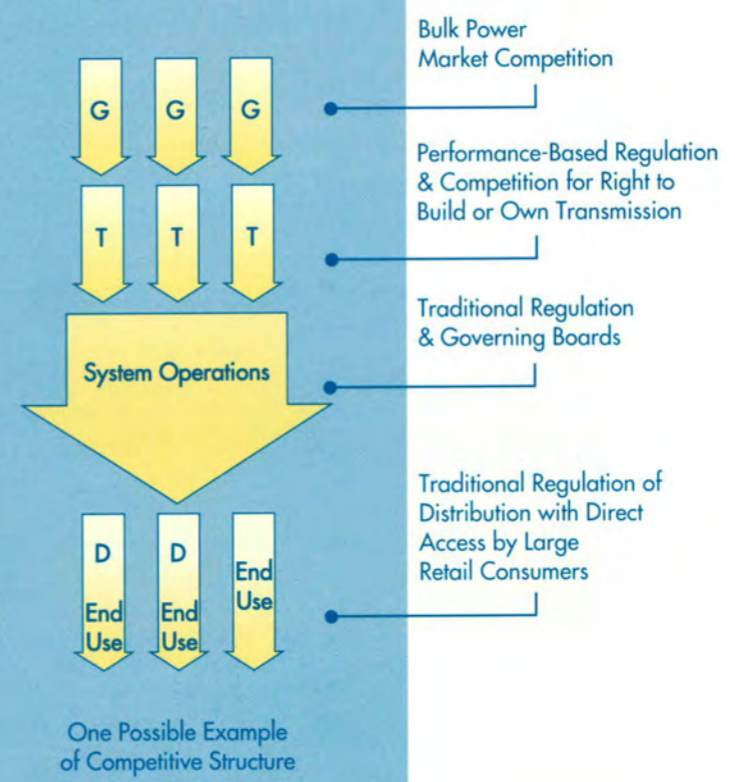
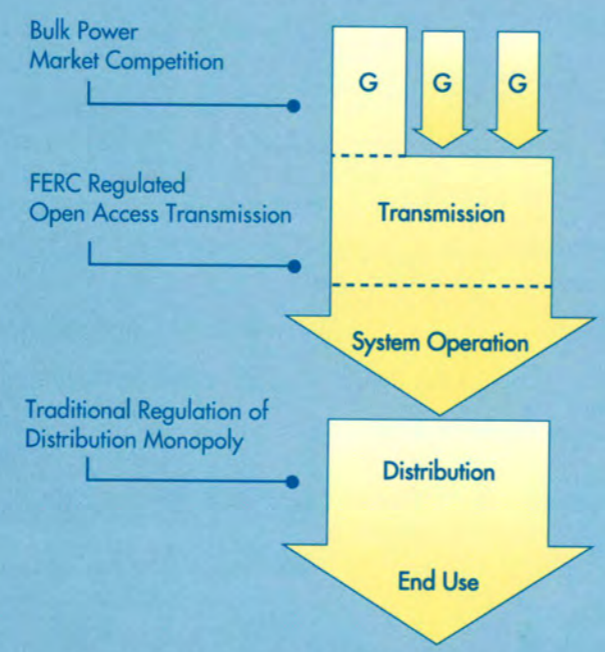
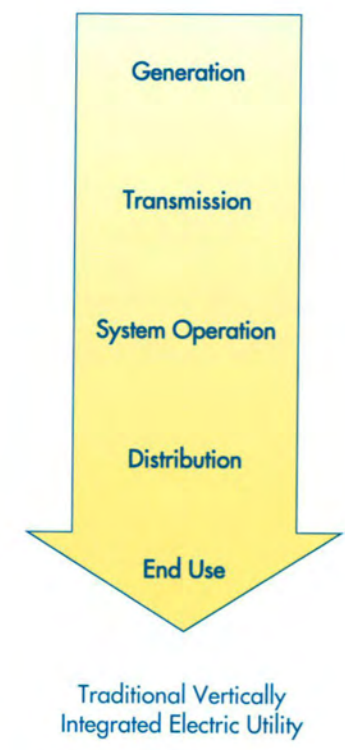
BPA's Statutory Missions

BPA's purposes or missions are laid out in federal statutes. They include the following:

- ▲ Provide electric power at its total system cost.
- ▲ Build and maintain a reliable transmission system.
- ▲ Give preference for federal power to municipal systems, public utility districts and rural cooperatives.
- ▲ Provide for the participation and consultation of the public in regional plans and programs.
- ▲ Exchange federal power with higher-cost utilities to share regional hydro system benefits with their residential and small farm customers.
- ▲ Protect, mitigate and enhance fish and wildlife affected by federal hydroelectric development in the Columbia Basin.
- ▲ Provide leadership in achieving the region's cost-effective potential for energy conservation and renewable energy resources.
- ▲ Recover costs necessary to produce, transmit and conserve resources to meet electric power requirements.
- ▲ Give preference for federal power to the Pacific Northwest.

In addition to its other mandates, BPA recognizes that it has a trust responsibility that grows out of the historical relationship between the federal government and the Columbia River Treaty Tribes.

Evolving Industry Structure



The electric utility industry is evolving rapidly from its traditional integrated structure toward a more diverse and fragmented form. This change is only one of the influences shaping BPA's future. Today, three major developments are converging to challenge BPA. These are unprecedented **competition, new Endangered Species Act requirements** and **the changing role of federal government**. These are over and above continuing challenges that include high fixed costs, particularly related to nuclear investments; a hydro system that is dominated by the weather; and unpredictable revenues from aluminum customers whose fortunes fluctuate widely with world prices.

II. Current Challenges

Restructuring the Electric Utility Industry

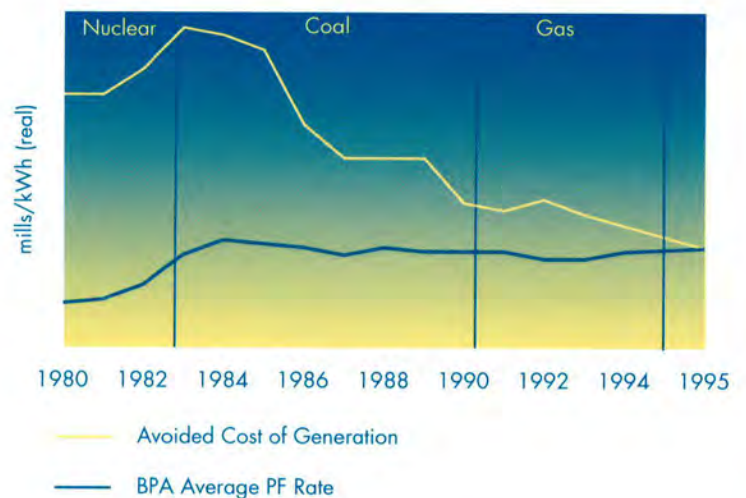
Traditionally, the electric power that serves consumers' energy needs has come from vertically integrated utilities that own the generators that produce power, the transmission systems that move power from the generators to load centers, and the distribution systems that connect the power system to the homes or businesses where it is used. This pattern began to change with the Public Utility Regulatory Policy Act (PURPA) in 1978, which required utilities to buy power from certain types of independent power generators (such as cogenerators and renewable resources). The National Energy Policy Act of 1992 opened up wholesale power markets further by granting the Federal Energy Regulatory Commission (FERC) the authority to order access to transmission facilities and thereby encourage wholesale power marketing competition between utilities and independent power producers. One of the objectives of the Act was to reduce the cost of electricity to consumers.

The FERC has proposed rules that would further alter the structure of the utility industry by requiring "functional separation" of utilities' power generation business from their power transmission business. These proposed rules, known as the FERC NOPR on open access transmission, and related regulations at the state level, may lead to consolidating currently separate transmission systems under a single transmission system operator independent from power marketing activities, and new arrangements for power marketing, such as centralized pooling arrangements, or direct access to the power market place for retail loads.

The exact form of the restructured utility industry in the United States is still taking shape. Competition has arrived unevenly, operating primarily in the wholesale power markets. Because all of BPA's sales are wholesale, essentially 100 percent of its load is at risk. Franchised utilities, such as investor-owned and consumer-owned entities, do not face direct competition for most of their retail load. Some generating utilities engage in the wholesale power market, but they usually obtain a much smaller amount of their revenue from wholesale markets compared with their captive retail market. For most, no more than 5 to 10 percent of their wholesale sales is open to competition. Because BPA has so much load at stake, the pace and direction of restructuring will markedly impact BPA's competitiveness.

Competition

The wholesale electric utility industry is undergoing an historic transformation, brought on by open transmission access, falling fuel prices, and the emergence of new and aggressive competition. For the first time, BPA must face the specter of load loss as its customers have a variety of economically viable choices.



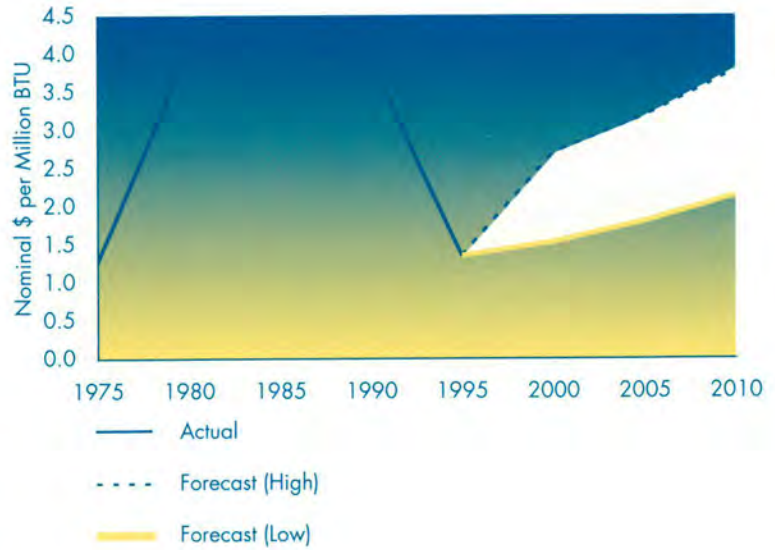
In addition, a recent proposal by the Federal Energy Regulatory Commission, designed to open up transmission and encourage competition, has set off discussions nationwide that could lead to dramatic restructuring of the entire electric utility industry. Competition from world markets underlies the need to make U.S. industry more competitive. As home to a substantial portion of the U.S. aluminum industry and a number of export-dependent industries, the Northwest has had first-hand experience with global competition. Fluctuating aluminum prices in the 1980s led BPA to adopt a variable rate for aluminum smelters to help stabilize their operations and BPA's revenues.

For the wholesale electricity industry, the low cost and apparently long-term availability of gas supplies, along with open access to transmission, have accelerated competition for power sales beyond all initial predictions. In the West, this competition has been reinforced by the near-term availability of large amounts of surplus gas-fired generation from California, which was also made cheaper by abundant low-cost natural gas.

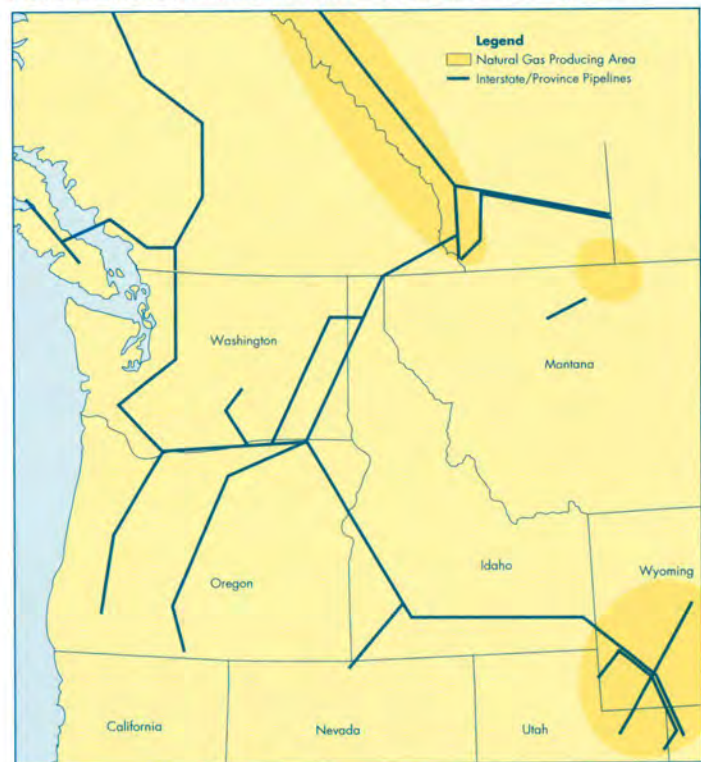
This presents a particularly intense challenge for BPA, which is solely a wholesale marketer without the security of an exclusive retail service territory. All of BPA's sales are at stake, compared to the relatively small percentages of sales that other utilities typically derive from the wholesale market.

In addition to existing utilities and new independent power producers, BPA also is competing against well-funded power marketers and brokers. As a result, BPA customers are receiving long-term, low-cost firm power supply offers from a variety of entities — independent power producers, marketers, brokers and other utilities.

Natural Gas Fuel Costs for Pacific Northwest Electric Generating Plants



Pacific Northwest Natural Gas Production and Pipelines



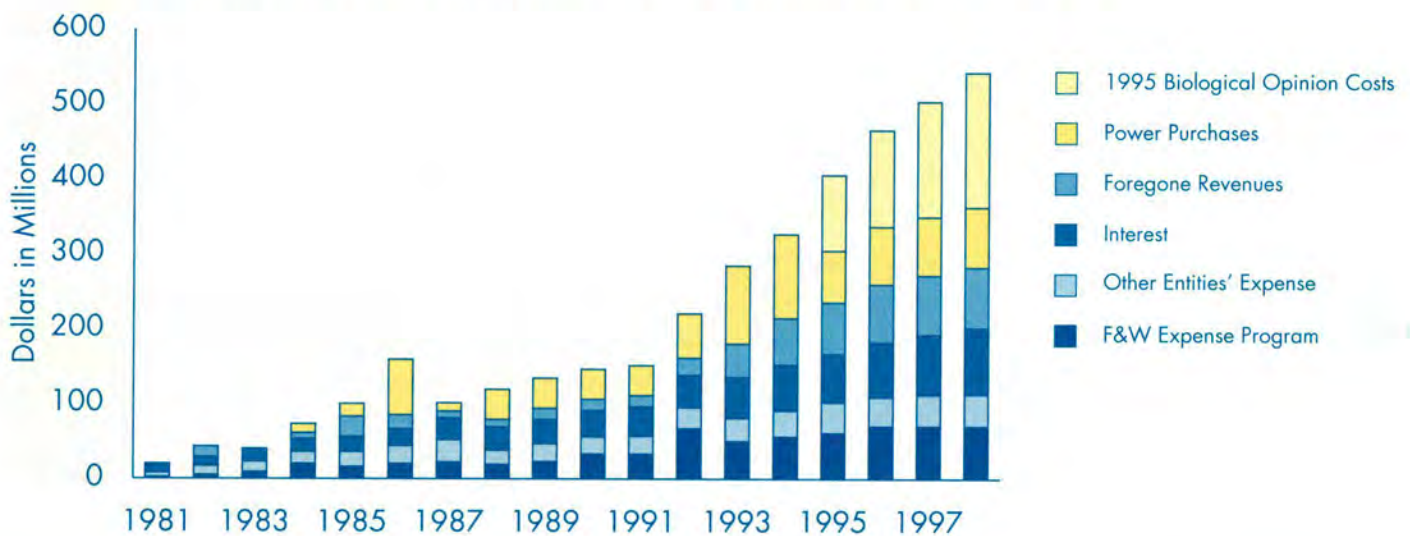
The Pacific Northwest has access to extensive natural gas fields

New Endangered Species Act Requirements

As BPA faces increased competition, it also is taking on new costs. Recent measures for salmon mitigation under the Endangered Species Act (ESA) have had dual impacts. Since 1991, BPA's annual investment for fish and wildlife has risen from \$150 million to about \$400 million in 1995, including capital expenditures, replacement power and lost revenues. As other measures phase in, BPA's annual fish and wildlife investment is expected to increase to \$675 million in 2001. In addition, significant ESA-required changes in the operation of the hydropower system have reduced operating flexibility and further curtailed revenues.

While fish and wildlife costs are still smaller than the fixed debt payments for nuclear investments BPA contracted for in the 1970s, they are new costs that have been accelerating rapidly and may continue to grow. As a result, they present an increasing cost pressure at a time when BPA must reduce prices. BPA's customers acknowledge that the prospect of further increases in these costs is one of the major influences motivating them to shift load from BPA to other power suppliers.

How BPA's Fish & Wildlife Investments Have Increased Over Time



The Changing Role of Government

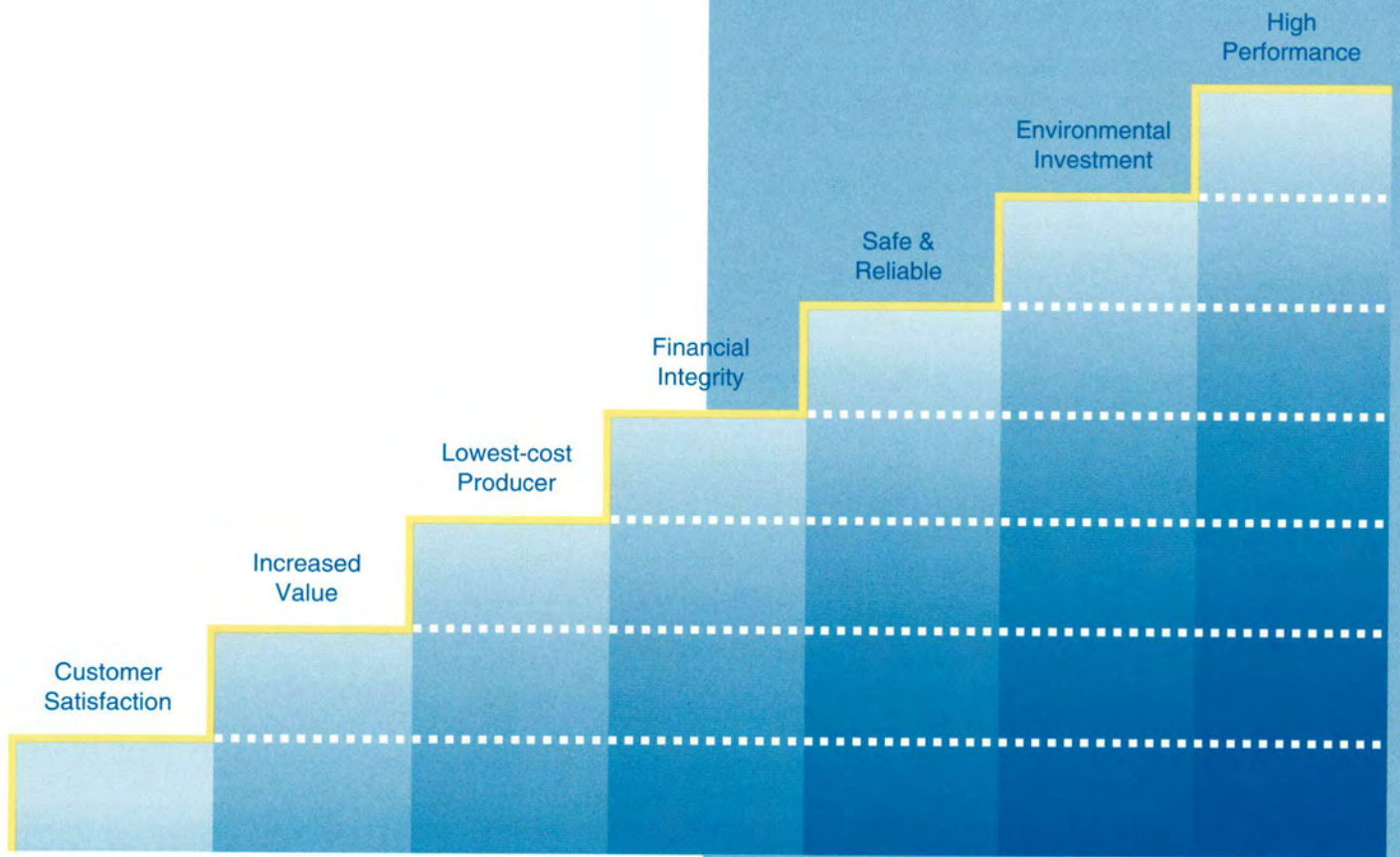
In concert with the changes in the electric utility industry, there are new expectations of government. The public is demanding more efficient use of resources and better service — greater accountability — from government at all levels. As the funds to carry out public missions become increasingly limited, federal agencies must define new and creative ways to accomplish their missions that don't depend solely on the distribution of money.

These challenges have had a profound effect on BPA. For nearly six decades, BPA had no serious competition as the wholesale electricity supplier to public utilities, municipalities and large direct-service industries in the Pacific Northwest. That position was due primarily to the substantial benefits of harnessing low-cost, clean hydropower. Given BPA's cost advantage, customers and other stakeholders agreed to expand BPA's role into valuable public services and recover the costs, both direct and indirect, through BPA's low power rates.

Today, however, there are dozens of wholesale electricity suppliers competing in the Northwest market. BPA still has relatively low rates, but, as in other competitive industries, it must let the marketplace determine competitive prices and terms for service to its long-established customers. The combination of these new developments and BPA's continuing challenges has caused BPA to rethink its basic approaches to delivering its public benefits. To continue to provide the public benefits that the region relies upon, BPA has had to learn new ways to achieve the same results more efficiently, with fewer staff and lower costs, through market-based approaches that allow BPA to maintain competitive rates.

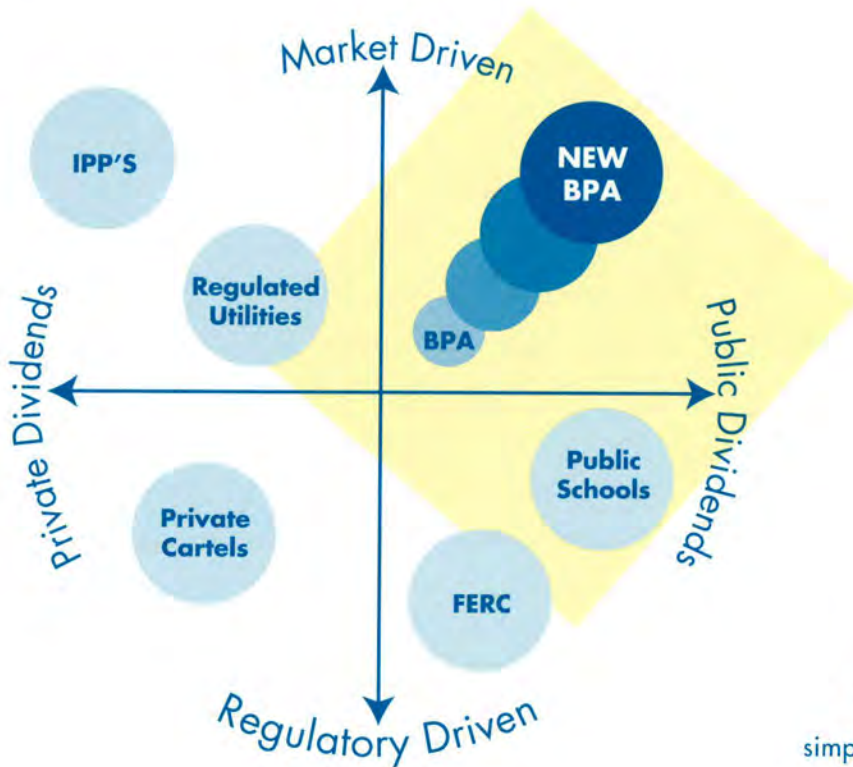
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Essential Building Blocks to Success



BPA is responding to these challenges by transforming itself into a highly efficient federal enterprise that acts like a business in the marketplace to better achieve its public service mandates. Each step BPA has taken and continues to take is designed to make the agency **market-driven, cost-conscious, customer-focused** and **results-oriented**. These four ideals, articulated at the start of the Competitiveness Project in early 1993, have become watchwords for the agency. They were the starting point for the seven strategic business objectives that are the essence of BPA's new direction. The strategic business objectives define the essential building blocks for BPA's future success.

III. Meeting the Challenges



BPA is not adopting new missions, but simply is enhancing the means by which to provide those public dividends that Congress has already defined. As illustrated above, there

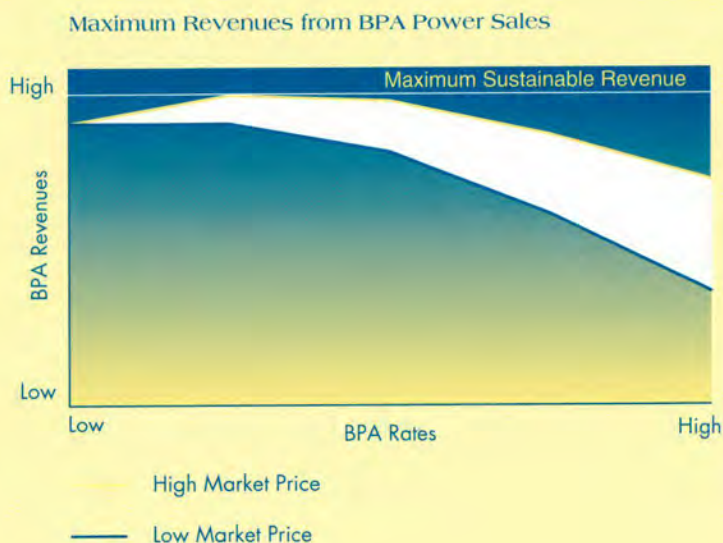
is a wide range of possible relationships between an institution's ends and the means by which it achieves those ends. The ends an institution may pursue can range from individual gain to general public benefits. The means to achieve those ends can be based on government controls or market forces. BPA is positioning itself to increase its public benefits by relying on market forces, with flexibility to adapt to changing customer needs, changing competition and changing expectations about the public benefits BPA should deliver.

BPA's historical role remains important, but it is no longer sufficient by itself. Providing safe and reliable power must be augmented by providing high customer satisfaction. The market, as well as cost, must determine pricing for products and services. Low prices must be complemented by long-term price certainty. BPA must achieve public benefits while relying less on grants and subsidies. BPA may increase revenues only by enhancing and expanding its products and services, and by securing new markets. Now that customers have alternative choices, BPA no longer has the option to raise prices to increase revenues. In fact, price increases will almost certainly have the opposite effect, because they will spur customers to buy their power from other suppliers instead of BPA.

Sustainable Revenues

One driving force behind BPA's new direction is the need to match costs with sustainable revenues. Prior to intense wholesale market competition, BPA rate levels were determined by expected costs. Now BPA must set its prices to meet the competition. New transmission or fish investments can no longer be covered by rate increases with any confidence that such a step will increase revenues. Now that BPA customers have choices, they can and will go to other suppliers if BPA's prices or service cannot compete.

Depending on the market price for power, an increase in BPA's rates could cause BPA's revenues to drop as customers take their business to other suppliers. The lower the market price for power, the more BPA risks losing revenues by raising its rates. BPA's revenues are maximized by keeping rates competitive with market prices.



Business Goals

BPA's Business Plan is a long-term strategy for growth. Growth in benefits BPA provides to the region will be fueled by growth in BPA's business value.

For over 50 years BPA has delivered valuable products and services to customers and major benefits to its stakeholders. The future promises new and different challenges. Some customers, stakeholders and employees question whether BPA can surmount these difficult challenges. Others question whether BPA can or should remain an institution in the Pacific Northwest. This Business Plan provides a framework for continuing the successful tradition in a new business environment.

"Growth" in today's competitive and changing environment is difficult. The restructured market offers new choices to purchasers. The market price for BPA's historical core product, firm electric power, has fallen substantially. BPA understands that some customers are making new product choices and others have diversified or are considering diversifying to other suppliers.

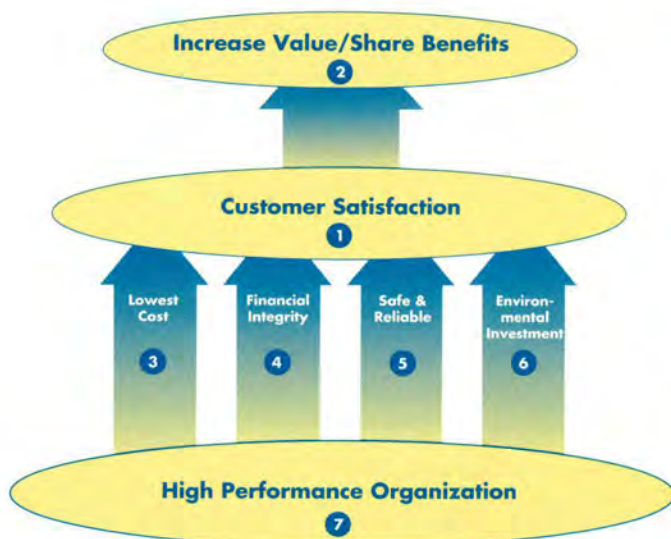
BPA is responding to these challenges and expects to reduce and then to reverse any losses. BPA's traditional type of firm power sales likely will decline somewhat over the next few years, but the long-term goal, over the next five to ten years, is that the total value of BPA

products, including new products, will grow. Rather than seek growth only in traditional areas, BPA has restructured into three business lines — power, transmission and energy services. Equipped with the varied products in these business lines, BPA will seek new customers and new markets, and regain former customers sufficient to achieve this added business value.

Historically, BPA's greatest strength has been its ability to adapt to change. This Business Plan's goal is for BPA to adapt, change and ultimately grow.

Essential Building Blocks to Success

As a federal enterprise conducting business in the marketplace, BPA must assume those characteristics that make for a successful business. To this end, BPA developed seven Strategic Business Objectives that focus on what BPA intends to achieve.



Objective 1: Achieve high and continually improving customer satisfaction. Customer satisfaction has always been BPA's objective, but sharp competition requires a renewed emphasis on achieving extremely high customer satisfaction. In today's utility industry, BPA's customers have numerous choices. BPA must compete for them. BPA can no longer rely on an inherent price advantage.

Objective 2: Increase the value of our business and share the expanded benefits. BPA is more than a business, but BPA must succeed as a business in a competitive market if it is to carry out its legislative mandates. Market success gives BPA the financial strength

necessary to deliver both commercial and public benefits.

Objective 3: Be the lowest-cost producer of power and transmission services. The realities of an increasingly competitive marketplace make low-cost production essential to BPA's survival. Cost control is vital, but being lowest-cost producer also means optimizing the use of all assets and using competition among suppliers to keep costs down.

Objective 4: Achieve and maintain financial integrity. Financial integrity includes maintaining economic access to capital; assuring full and timely payments to creditors; recovering all costs over time; and providing high quality and timely financial information to BPA managers and other interested parties.

Objective 5: Keep the power system safe and reliable. BPA has an exemplary record of safety and reliability. Continuing this record is a key to BPA's competitive success.

Objective 6: Invest in environmental results to sustain competitiveness. BPA is committed to maintaining the integrity of the region's environmental and natural resources because they are essential to the quality of life in the Northwest, and because strategic environmental effectiveness helps sustain competitiveness.

Objective 7: Transform BPA into a high-performing, business-oriented organization. Business strategy may chart the course for an organization, but BPA recognizes that its people — enabled by structure, systems, process and culture — achieve the results. BPA is committed to developing a work environment that enables its people to accomplish the strategic business objectives and to feel a high sense of satisfaction.

The seven strategic business objectives are interrelated. The foundation for all of the objectives is Objective 7, to transform BPA into a high-performing business-oriented organization. High performance will enable BPA to be the lowest cost producer of power and transmission services (Objective 3), to maintain financial integrity (Objective 4), to keep the power system safe and reliable (Objective 5), and to invest in environmental results (Objective 6). Sharing the expanded benefits of BPA's operations with the region will increase customer satisfaction (Objective 1). Achieving those objectives will increase the value of BPA's business and allow BPA to share the expanded benefits of its efforts (Objective 2).

To ensure it realizes its strategic business objectives, BPA also developed "critical success indicators." These indicators define benchmarks against which BPA can measure success in meeting its objectives. These indicators are integral parts of strategic action plans for BPA's activities, and provide specific quantifiable standards of performance. BPA will monitor its performance during each operating year, and make adjustments as necessary to sustain progress toward its objectives.

Broad goals and objectives must be achieved through the day-to-day activities of the organization. BPA's Strategic Business Objectives and Critical Success Indicators inform Strategic Action Plans for each of BPA's major functions. Strategic Action Plans provide direction for annual operating plans and action plans for individual work groups. Plans at each level translate the direction of the Strategic Business Objectives into more specific guidance so that everyone works together to reach the goal.



Meeting the Market
Managing Cost
Financial Strategy
Management and
Organization
Legislative Initiatives

To lay the groundwork for achieving its Strategic Business Objectives, BPA has launched a number of initiatives and is employing a wide array of tools. These break out into four general areas: (1) meeting the market, (2) managing costs, (3) financial strategy, and (4) management and organization. Legislators from within the region and from elsewhere in the nation are exploring additional legislative initiatives, which also may enhance BPA's ability to achieve its mandates.



IV. Tools for Success

Much of BPA's planning and budgeting has been driven by an awareness of the "revenue gap" between estimated costs and expected sustainable revenues from the new competitive market. Prior to the start of the Competitiveness Project, BPA's costs were increasing rapidly from year to year. Since the initial draft marketing plan in late 1993, BPA has worked to close the gap through cost reductions and program reinventions, while emphasizing marketing to increase revenue. Declining prices and other market developments have made increasingly stronger measures necessary. The result of these efforts is that, with some flexibility in the probability of Treasury payments as a backup measure, BPA can balance its costs against its revenues even in the face of the rapidly evolving competitive market. Annual reductions in BPA's projected costs average nearly \$500 million over the next five years when compared to the 1995 Congressional budget submission. BPA will continue its efforts to reduce costs, for it is clear that further cost management will be necessary to meet the competitive market.

1. Meeting the Market

BPA's marketing goal is to continue serving most of its traditional customer loads, while increasing revenues over the long term by expanding its business into new markets and new product lines.

BPA's Position before the Business Plan

As BPA began formulating its Business Plan, BPA faced a major loss of revenue from its traditional customers for a number of reasons, including falling prices, customer dissatisfaction and new competition. Opening up transmission access for wholesale power marketing also put increased demands on BPA.

Although the average cost of BPA power has been and continues to be among the lowest in the utility industry, wholesale power prices have dropped due to low natural gas prices and surplus generation on the West Coast. In many cases, wholesale market prices are at the variable cost of existing generating resources. Fierce competition among the many players in the wholesale market helps ensure that prices find their lowest level.

Utilities competing with BPA typically can recover most of their fixed costs from sales to "captive" retail consumers. BPA has no such secure sales base. All of BPA's power revenues come from sales in the deregulated wholesale market, and all of BPA's large wholesale customer base is at risk in the competitive market over the next few years. BPA serves about half of the electrical loads of Pacific Northwest generating public utilities, virtually all of the non-generating public utility loads and almost all of the direct service industry loads.

Many of BPA's customers are considering diversifying their power supplies by buying from other sources. Customers' interest in diversifying their suppliers, even at prices slightly above BPA's current rates, is to some extent based on their perceptions that, in the past, BPA was bureaucratic, unresponsive and subject to uncontrollable cost increases.

New entrants to the wholesale electric power market include marketers, independent power producers, and new and aggressive marketing arms of other utilities from throughout the country. Requests for proposals for power resources from utilities or their representatives attract offers from dozens of suppliers, totaling many times the amount of power requested.

BPA continues to be the largest transmission provider in the region, with over three quarters of the region's high-voltage transmission. New regulations providing open access to all wholesale users mean BPA may be required to provide even more wheeling services for nonfederal power than in the past.

These developments demonstrated that BPA had to make major changes in its marketing to continue its vital role of service to the region.

Challenges

BPA faces many challenges in this market. The most important are:

- ▲ pricing BPA power competitively with other suppliers;
- ▲ improving marketing to meet the needs and resolve the concerns of existing customers; and
- ▲ adapting to open transmission access.

Under past practices, BPA's rates would have risen to noncompetitive levels, above market prices, as costs pushed revenue requirements higher. If BPA is to succeed, it must offer prices that match those of its competitors.

Along with competitive prices, BPA must build stronger relationships with its customers. It must address their concerns about past difficulties of doing business with BPA and their fears about the future. As with price, BPA must match the competition in responsiveness, flexibility and customer service.

BPA must meet
the competition while
continuing to provide
fair and equitable
transmission access
to all eligible
transmission users.

Finally, BPA must meet the competition while continuing to provide fair and equitable transmission access to all eligible transmission users under new laws and pending regulations. BPA will offer services and prices for transmission of nonfederal power that are comparable to the terms for transmission of its own power, and will maintain transmission as a separate business that doesn't favor BPA's own power marketing.

Actions BPA Has Taken to Meet the Challenges

Recognizing the need to change with the market, BPA has taken action to respond to each of the above challenges.

Competitive Pricing

If any one factor is critical to BPA's competitiveness, it is the ability to offer power to customers at prices that meet the competition. New rate proposals give BPA new flexibility to offer lower prices and more flexible terms, and to match offers with other suppliers who are seeking to serve BPA's traditional customers.

Market Pricing

If BPA is to fulfill its statutory missions, it must price its products and services to compete for and retain market share. BPA will provide needed products at low benchmark prices, while setting rates to recover its total system costs. BPA may price some products below cost as a short-term measure when a sustainable revenues analysis shows that pricing at cost would generate fewer revenues.

For example, starting in 1996, BPA proposes to reduce its priority firm power and industrial firm power rates by an average of about 10 percent. This is the largest rate reduction in BPA's 58-year history. This reduction makes BPA prices comparable to or lower than offers other suppliers have been making to BPA's customers.

BPA's long-term strategy is to continue to price core requirements products at cost, while selling other unbundled products and energy services at market prices.

Pricing Certainty and Flexibility

To reinforce competitive pricing, BPA has proposed new rate designs that are longer-term and more flexible. In addition to the conventional two-year rate schedule for firm requirements power, new rate packages include:

- ▲ Optional five-year requirements rate schedules for Priority Firm Power, New Resource Firm Power and Industrial Firm Power.

- ▲ Two new flexible rate schedules: the Firm Power Products and Services (FPS) rate schedule and a newly-redesigned Variable Industrial rate schedule.
- ▲ As necessary, a 10-year term under the FPS rate schedule.

The five-year rate schedule recognizes customer needs for rate stability along with competitive pricing. Under the optional five-year schedule (a two year schedule also is available), BPA will be able to provide greater rate certainty over a longer term. This helps customers to plan on a longer horizon, while BPA benefits from greater revenue stability as customers commit to a five-year purchase. Customers also will have greater flexibility because they can split their load between the two and five year schedules, allowing them to compare prices from other suppliers. Requirements service also will include pricing flexibility to accommodate unique features in individual contracts.

These pricing proposals will give customers lower prices, stability and flexible new choices, while giving BPA greater certainty about its expected loads and revenues. BPA will be able to use pricing flexibility to respond to changes in the market for unbundled products.

Building Stronger Relationships with Customers

The pricing initiatives described above are an important step toward resolving customers' concerns about doing business with BPA, but other actions also are needed to show that BPA is a responsive and reliable business partner. The initiatives in contracting and product unbundling described here will help BPA's customers by giving them greater flexibility in identifying and meeting their own unique needs. These marketing strategies, as well as the new approaches to pricing, are delivered to customers through BPA's new customer-oriented organization.

Tiered Rates

BPA's draft business plan called for tiered rates for firm power. This proposal has been deferred due to the current low power prices. Tiered rates could be an important tool in the future if market conditions warrant.

Tiered rates are used to send a "market price signal," reflecting actual costs of providing power resources. While the first tier is priced at the cost of existing resources, the second tier is priced at the cost of new resources. When the market price for new resources is above BPA's average cost, tiered rates give BPA's customers a price signal to use power efficiently while at the same time allowing them to receive the benefits of low-cost federal power.

The premise of tiering is that new power resources will cost significantly more than existing resources. That is not the case now, due to the fall in wholesale market prices. Tiered rates, intended to indicate marginal cost, are only useful when there is a significant difference in cost between existing and new energy resources.

Customer-Friendly Contracts

In the past, BPA's power sales contracts were written to cover every customer and every possible circumstance. As a result, the contracts were long, complex and full of material that did not apply to most customers. Utility managers found the contracts difficult to use and confusing, and asked for new contracts that are simpler.

BPA has moved quickly to redesign its proposed new power sales contracts to be short and easy to read. With input from customers and the public, BPA contracts staff have developed several contract templates (including full requirements, partial requirements and residential exchange contracts). Their purpose is to define the business relationship between BPA and its customers and to build stronger partnerships with those customers. They cover the most common customer transactions, but also are flexible enough to be tailored to specific needs. BPA plans to conduct one-on-one negotiations with individual customers using the templates as a foundation to develop a truly customized contract with each customer. BPA also is pursuing legislative authority (as a government corporation or by other means) to enable it to offer binding arbitration as a means of resolving contract disagreements.

Business Lines: Independent Production Centers

BPA has divided its products and services into three distinct business lines, each accountable as an independent cost center. Together, these business lines will provide customers with a full range of options. The business lines include power, transmission and energy services.

Power Business Line: The goal of the Power Business Line is to develop core products (such as energy and capacity), as well as a diverse array of other products that maximize BPA's power resource services, such as system flexibility and storage capabilities, to allow BPA to move into any accessible and profitable market. BPA expects opportunities for new business to grow with increased retail and wholesale competition. The Power Business Line will position BPA products to take advantage of these opportunities. The options will include standard products as well as products that can be modified to meet unique needs.

Transmission Business Line: This business line includes both the delivery of federal power to BPA's power customers and wheeling services (transmitting power to other suppliers' customers over BPA's system). BPA intends to remain the bulk power transmitter "of choice" for the Northwest by providing fair and open access to its grid at prices and terms comparable to those BPA applies to itself. By further

New contract
templates are a
foundation for truly
customized contracts.

opening up its transmission system, BPA will foster additional competition and increase its marketing options. The first priority will be providing reliable transmission for existing firm power and transmission obligations. In the event of competing requests for new services over limited transmission capacity, priority will go to providing adequate and reliable service to Northwest loads.

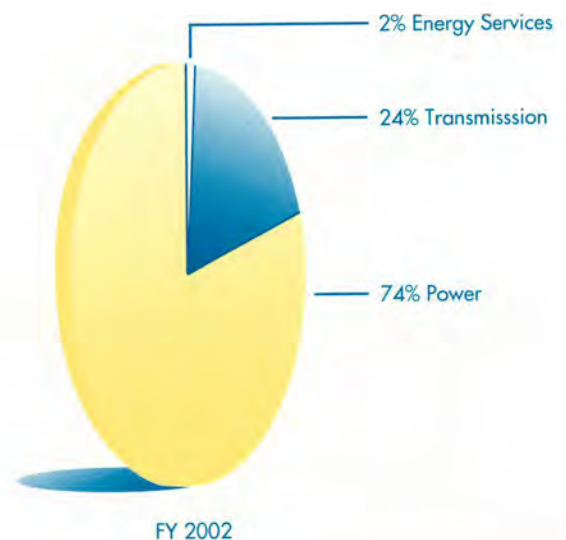
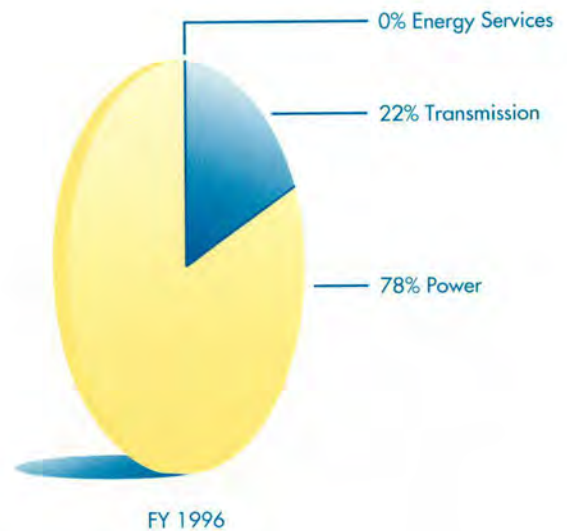
Energy Services Business Line: Services in this business line focus on those that are best delivered to the end users through their retail utility. These services will enhance the retail utility's market position by reinforcing the positive relationship it has with its customers through personalized services delivered locally. The first product line BPA will offer under this business line includes demand side management (DSM) services. The DSM product line will support existing and new utility conservation programs with a range of planning and analytical services. Other product lines could include laboratory and technical services; transmission and engineering services; power quality services; and environmental services. These product lines grow out of BPA's core competencies and will provide both utility and end-use customers with high value products and services that complement the *bundled* and *unbundled* products offered by BPA's power and transmission business lines. Energy services is the newest business line, and BPA expects that it will take time to refine the line and build momentum. BPA expects this line to be self-supporting by the year 2000.

Unbundled Products and Services

For decades, most of BPA's services have been sold in virtually the same package to every customer. Everyone had about the same choice, and everyone paid for roughly the same package although some customers couldn't make use of some of the services included in the package.

Times have changed, and now there are many choices. Customers will be able to buy BPA's products from three separate business lines (power, transmission and energy services), individually or as part of a package, better assuring that they buy only what they want. Unbundled products and services will

Percentage of Operating Revenues by Business Line





Products and Services for Each Customer's Needs

Different customers have different needs. BPA is offering unbundled products and services so that each customer has the flexibility to choose the exact combination of products and services that it requires.

In the past, all of BPA's customers got about the same kind of service: BPA would supply power to meet their net loads throughout each month, and then bill the customer for the power delivered according to rate schedules. Now, customers can specify the services they want from BPA, and which they will provide for themselves or buy from other suppliers.

Customers may choose to buy specific products in amounts they decide, or fixed blocks of power at specified times of the day or year, while relying on their own resources or the market to meet their remaining needs. They may choose packages of products designed to complement energy resources they plan to acquire, to simplify the task of managing those resources. Or they may rely entirely on BPA for all of their needs, as many of BPA's customers have done for years.

include firm energy, demand, load shaping, load regulation and in-lieu power for the residential exchange. BPA will offer unbundled products to meet instantaneous loads of requirements customers under the priority firm, new resources and industrial power rate schedules. These products will include sales from short-term hydro operation as well as longer-term sales. Additional products, such as resource integration services, will be available under the Firm

Power Products and Services (FPS) rate schedule. BPA will offer some of its unbundled products services under an Ancillary Products and Services rate schedule.

Customers will be able to purchase all or a portion of their monthly designated capacity and energy, but must take or pay for the amount they designate. They also may choose load regulation, shaping and resource services as part of an unbundled product line to complement the capacity and energy they buy.

Rebundled Products and Services

For customers who prefer not to manage their own portfolio of products and services, BPA will rebundle individual products and services into packages that meet the firm needs of specific customer segments. Full-service packages will include components from all three business lines. Customers can freely select whichever package or combination of services they believe best fits their circumstances.

New Services and Products

Unbundling and rebundling BPA's traditional products and services will help better meet customers' traditional needs. BPA also can help its customers by offering new services that go beyond wholesale power and transmission. These new services and products can meet the business needs of BPA's customers while diversifying and building BPA's revenue base.

BPA is beginning to develop its potential for new services and increased revenues by marketing new products and services such as fiber optics, demand side management, and engineering and environmental consulting services. Because of its size, resources and expertise, BPA has considerable untapped potential to provide innovative products and services. BPA expects to phase in new products over the next five years. These products are the foundation for the energy services business, the newest of BPA's three business lines.

Customers' Ability to Choose Power Suppliers

A business must be sensitive to the long-term impacts of decisions. By acknowledging that customers will inevitably have freedom to choose other power suppliers, BPA has chosen not to try to force its customers to continue buying all of their power from BPA. Technically, BPA appears to be able to hold on to a significant portion of its load because its current requirements power sales contracts don't expire until 2001. Large amounts of BPA's load could leave in the near term, however. Industrial customers, for example, can terminate their contracts with one year's notice and have certain rights to replace BPA power. Utility customers can take load off BPA each year (on a first-come, first-served basis) to the extent BPA projects a resource deficit.



Even without these near-term opportunities, all of BPA's customers will be able to obtain service from other suppliers starting in 2001. Under these circumstances, rigid use of existing contracts to hold on to loads for the present will likely reinforce customers' desire to escape BPA service when current contracts expire. Recognizing this potential, BPA has decided to accede to a certain amount of customer diversification. At the same time, BPA is working to assure that customers who reduce their BPA loads do not unfairly impose stranded investment costs and other cost obligations (such as fish and wildlife investments) on customers that continue BPA service. BPA is seeking an administrative, rather than a legislative, solution to this complex and highly charged issue.

Stranded Investments

Existing utilities and federal power marketing agencies hold billions of dollars in investments made when they could rely on long-term sales to recover their costs. Competition may lead to massive write-offs and financial upheaval among those suppliers, as unencumbered competitors undercut prices from traditional sellers and attract the very loads that were the reason for investments in generation and transmission facilities. Much of this upheaval could be avoided by allowing a gradual transition to a competitive market. One of the tools that could smooth the transition is stranded investment charges which place some of the financial responsibility for power system investments with the customers whose loads were the basis for the investments.

The delicate balance is one of free choice on the one hand and responsibility on the other. Exit fees, wire charges or other mechanisms to recover these investments are likely to alienate established customers and may present themselves as barriers to new customers considering doing business with BPA, particularly when these customers have alternative offers with no such strings attached.

On the other hand, to the degree that customers can escape from sharing in the costs of these investments, they pass a larger burden on to those customers who remain with the system. As customers have the opportunity to move to alternative resource providers, there is a need to assure that costs prudently incurred to serve the departing customers are addressed.

BPA is keeping its options open on dealing with stranded investments and seeks a policy that is equitable to existing customers, departing customers and new customers. Major tools to reduce the impacts of stranded investments continue to be intensive cost-cutting, stabilization of fish costs (which may include legislative remedies) and removal of market barriers to selling excess power.

FERC proposed rules recognize the concept of stranded investment as a significant issue for a transition from a regulated to a competitive market environment. It is likely that most, if not all, utilities competing in wholesale power markets will move to identify and recover some amount of stranded investment and improve their competitive position in the market.

BPA prefers a non-legislative solution to stranded investments, one that can be worked out between BPA and its customers. BPA is moving to address this issue now with its customers. The best outcome for BPA would be to compete successfully so that system investments never become "stranded."

Adapting to Open Transmission Access

Open Access to BPA Transmission

BPA supports open access to transmission and intends to be the transmission provider of choice for the Northwest. BPA is ahead of the industry as a result of its years of experience in providing access for nonfederal power to excess federal transmission capacity. Currently, about one third of the federal transmission system is committed to nonfederal use.

The whole area of transmission is in flux now. The West is leading the nation in using regional transmission groups to facilitate wholesale access. Pooled transmission and retail access may be available in the near future. BPA is prepared to move in these new directions by going forward with open access transmission tariffs and participation in regional transmission groups.

Separation of Power and Transmission Business Lines

A major element of the pending rules governing wholesale power transmission is a requirement that utilities manage their power and transmission functions as separate businesses. BPA is prepared to operate consistent with these new rules. Since the 1970s, BPA's rates for power and transmission have been based on accounting separately for the costs of each function. In addition, BPA's new organization already separates power and transmission into separate businesses. BPA will take selective actions now, such as creating a transmission scheduling function separate from generation scheduling, and implementing an electronic bulletin board that can evolve into a real-time information network for transmission system users.

As the largest transmission operator in the Pacific Northwest, BPA expects to bear much of the responsibility for providing transmission access to other entities marketing power in the region. BPA has a proven record of fairness, neutrality and technical excellence in transmission services that will continue as the new market evolves.

Principles for Comparability of Transmission and Wheeling Charges

One of the keys to a competitive power market is open and nondiscriminatory access to transmission systems, so that all wholesale power purchasers have access to competing suppliers. Under the National Energy Policy Act of 1992 (EPA), Federal Energy Regulatory Commission (FERC) may order transmission owners to provide wheeling (that is, transmission of power that isn't owned by the transmission system owner). BPA has been a leader in wheeling services, with about a third of its transmission system committed to third party use.

BPA has worked with its customers to develop principles to assure that BPA has available prices, terms and conditions for BPA wheeling services that are comparable to those BPA applies to its own use of the transmission system. In brief, the transmission principles state that BPA transmission will not unfairly limit customers' access to non-BPA power, and that BPA will offer wheeling rates comparable to charges for transmission of federal power. BPA may reserve transmission capacity for service to contractually committed loads, and BPA has the option of charging incremental or lost opportunity costs where FERC guidelines and standards permit. The principles recognize special provisions in EPA that protect against losses due to wheeling transactions that lead to spill at hydroelectric projects.

Other principles require that (1) BPA operate its transmission system as a separate business line; (2) BPA identify the billing components for transmission of federal power; (3) BPA provide network, point-to-point, and nonfirm wheeling; and (4) the billing components for transmission of federal power be comparable to those for wheeling nonfederal power.

2. Managing Costs

Stabilizing BPA's position in the marketplace, and then expanding its business and its ability to perform its public service missions, requires BPA to reduce its current costs and then to manage its costs strategically into the future. BPA has to make tough and sometimes unpopular decisions before it can claim that it has stabilized its costs and rates. By making these difficult choices, BPA can regain its customers' long-term trust. The initiatives described below illustrate how BPA will manage its costs to assure improved security and stability for its customers.

BPA's Position before the Business Plan

As BPA has grown, its costs have increased. BPA funding has supported the world's largest fish and wildlife program, one of the largest energy conservation programs, and the most resilient and reliable power system in the world. It also fulfills commitments to pay the power costs of Columbia River hydro projects, and the costs of nuclear power plants that the region planned in the 1970s. Because competition was not a major concern at the time these commitments were made, the emphasis was on carrying out programs rather than on minimizing costs.

Challenges

Managing costs is critical to BPA if it is to fulfill its commitments. The missions are unchanged, but BPA must now find ways to achieve the same results at lower costs. The problem is further complicated because the majority of the costs BPA must pay are not entirely within its control, such as the costs of hydro operations, fish and wildlife programs, and nuclear power projects.

Actions BPA Has Taken to Meet the Challenges

BPA has made an ambitious effort to reduce costs and achieve stability. These efforts include systematic reductions in planned spending, review of existing spending commitments, and renewed attention to debt management.

Stringent Cost Controls

BPA has substantially reduced its costs and adopted strict cost-management targets based on the limits of sustainable revenues, with all costs subject to review. BPA will continue to reduce costs to stay within limits dictated by the market. In 1995, BPA made an additional \$250 million per year (average) cost reductions over its previous budget submittal to Congress, bringing total cost reductions over the next five years to an average of nearly half a billion dollars per year.

All parts of BPA are affected by the cost reductions. These cost reductions are among the most important means for keeping BPA competitive.

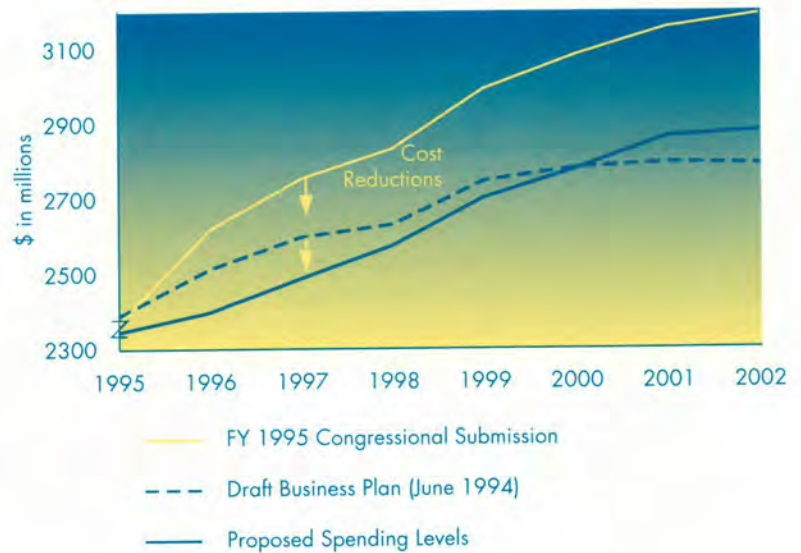
Even with nearly half a billion dollars in annual cost reductions, BPA's total operating expenses are still projected to go up about \$370 million between 1996 and 2000. This increase is due primarily to debt service, long-term power purchases, and additional fish and wildlife mitigation costs.

Reviewing Energy Resource Plans

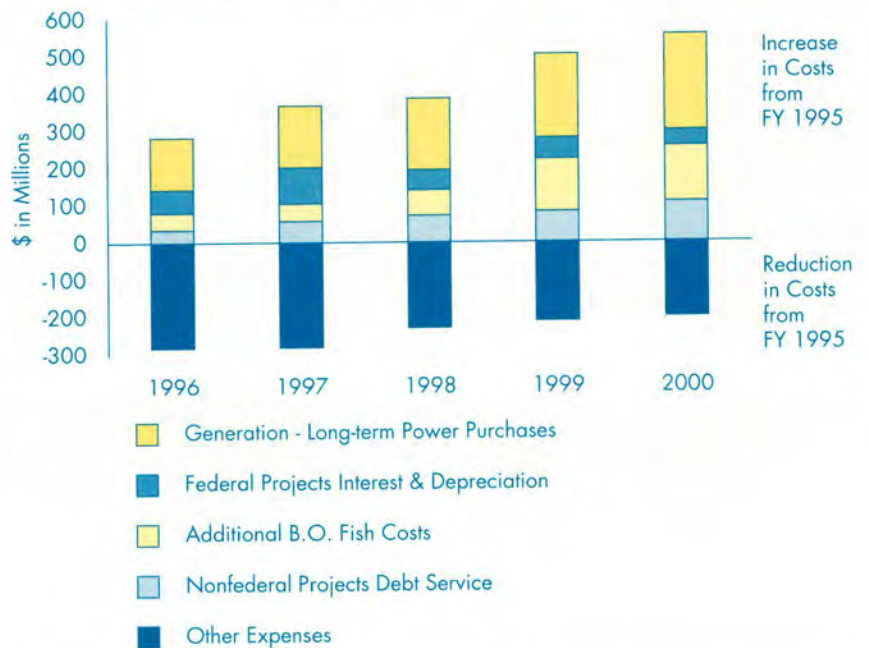
One major element of BPA's costs is energy resources. Market competition has undermined BPA's expectation that it will need to acquire new long-term energy resources to serve customers' load growth. To address changes in its need for power, BPA reviewed all of its planned new resources and either terminated or will terminate those that are no longer needed to serve load or, as in the case of the region's only operating nuclear project, set stringent cost management targets.

Rather than commit to further resource acquisitions, BPA will rely on power purchases and nonfirm power to meet load during the next five years, and possibly longer. Long-term forecasts indicate purchase power will be readily available at competitive prices. However, BPA will retain the option to acquire new resources in its Resource Contingency Program in the event they are needed, and to acquire specific resources to satisfy customer requests.

How BPA Has Reduced Costs to Stay Competitive



How Increases in Key Costs Offset BPA Cost Reductions



BPA's New Resource Strategy

In the past, when BPA could safely assume that it would be serving the growing loads of its customers, resource planning meant making sure that enough power would be available when consumers needed it, taking into account the uncertainty in load forecasts, and trying to get needed power at the lowest price. BPA's Resource Program was oriented around a "stack" of available energy resources arranged in order of increasing price. Plans to meet future loads would be prepared by selecting resources starting with the lowest cost layers in the stack, and moving up until there were enough resources to serve all forecast loads.

Competition in the utility industry introduces a major new consideration: BPA must be careful not to make long-term commitments to acquire power resources for loads it may not have; i.e., loads that move away from BPA service and obtain their power from BPA's competitors. In addition, because the operation of the hydro system has changed to provide additional flows for migrating salmon, there is a vast amount of very low-cost hydro power in the spring that makes almost any other type of generation unnecessary during the flow periods. If a new resource cannot be shut down during spring flow periods, BPA will be unable to take advantage of the required spring flows to reduce costs to its customers. These conditions demand resource flexibility as well as low cost.

These factors profoundly affect BPA's approach to power resource planning. The type of resource that fits best with the existing system under present conditions is a resource that can operate economically during periods of low hydro generation, but which can be shut off without incurring large costs when flows are high, whether the high flows are the result of good water years or fish flow requirements.

Only one type of resource fully fits these conditions: spot market power purchases. Power purchases are particularly attractive because they do not require capital investment or long-term financial obligations for BPA as a purchaser. New combined-cycle combustion turbine (CTs) are next best, but they would require long-term investments at a time when there would not be corresponding long-term load commitments from customers.

Other types of resources that appear in the resource stack, notably energy conservation and renewable resources, fit poorly, because they entail relatively large "front-end" investments that may not be recoverable if loads move away from BPA service; because they either cannot be shut down (such as conservation measures), or because cost savings from temporary shut-downs are a small portion of total costs. Even if low-cost hydro is available to displace these resources, BPA would have to continue to pay financing costs and possibly other costs to maintain the resources.

BPA continues to support the acquisition of energy conservation and renewable resources that are regionally cost-effective under the changed hydro operations and current market conditions. Utilities will fund most new conservation through locally-controlled programs, and BPA will support their efforts through its Energy Services business line. To the extent that its customers' acquisitions fall short of the Council's regional targets, BPA will develop programs to meet those targets. For those customers who are willing to contract for the purchase of renewable resources, BPA will supply "green" power at cost. BPA also will participate, with other utilities, in sponsoring market transformation conservation or renewable resource demonstration projects.

BPA's resource strategy for the immediate future is to rely on power purchases for any incremental power needs. The extensive surplus of generating capability on the West Coast, as well as forecast low natural gas prices, give BPA confidence that power will be available for purchase if the need arises.

Strategy for Renewable Resources

A major purpose of the Northwest Power Act is to encourage conservation and renewable resources in order to obtain the environmental benefits of these resources. Utilities can invest in these resources to diversify their energy supplies and to protect themselves against increases in fuel costs. BPA will continue to participate with other regional utilities and parties to support regionally cost-effective renewable resource pilot projects, provided the costs of such investments are shared and do not place BPA at a competitive disadvantage. BPA also will acquire renewable resources dedicated to specific customers provided those customers pay the cost of "green power." Finally, BPA will provide transmission and ancillary services to utility customers, as requested, to support their acquisition of renewable resources.

4(h)(10)(C) Credit

In 1994, the Administration endorsed the BPA Administrator's right to invoke section 4(h)(10)(C) of the Northwest Power Act, which allows the Administrator to allocate nonpower fish mitigation costs at federal hydro projects to nonpower purposes of those projects. Nearly one-third of the collective benefits of these projects goes to uses other than power — flood control, irrigation, navigation and recreation, for example. For the previous 15 years, electric ratepayers had shouldered the entire burden of mitigation measures.

BPA will continue to seek credits for future costs consistent with statute.

3. Financial Strategy

When BPA began the Competitiveness Project, projected costs were on a vigorous upward trend, while projected revenues were levelling out. In addition to the cost management efforts described above, BPA is employing a variety of financial management tools to close the "revenue gap" and strengthen BPA's financial position. These tools include prudent management of Treasury payments, improved capital planning techniques, managing and, where possible, reducing debt, and appropriate risk management strategies. In addition, BPA continues to refinance debt whenever possible to lower the costs of debt service, and is controlling new capital investments to reduce new borrowing. BPA also plans to finance a small portion of its own program from revenues.

BPA's Position before the Business Plan

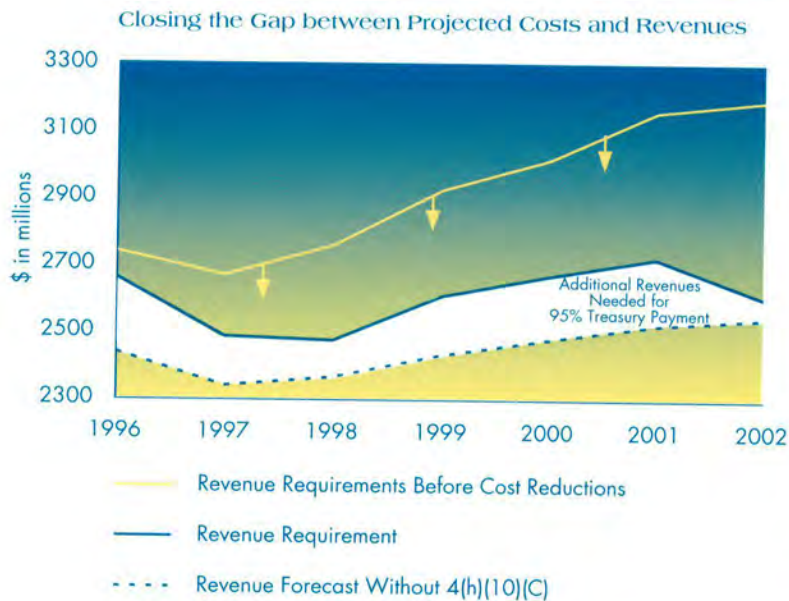
The upward trend in BPA's projected costs and the potential for exhausting BPA's statutory borrowing authority posed problems. The threat of competition brought a heightened need for strategies to avoid costs and long-term obligations, in order to give BPA greater flexibility.

Challenges

The financial challenges facing BPA are to reduce costs and long-term financial burdens while assuring that BPA has access to the financing necessary to accomplish its missions. Another challenge is to sustain BPA's financial integrity and maintain and improve the confidence of the financial community in BPA's credit worthiness.

Actions BPA Has Taken to Meet the Challenges

BPA has acted to improve its performance in all of its financial management activities. Through a review of its financial strategy in light of new developments in the electric power market, BPA has identified a number of steps to improve BPA's financial position and reduce risk.



Treasury Payment

For the past dozen years, BPA has consistently made its annual payments on its Treasury borrowing in full, and intends to continue doing so. Over the next 10 years, BPA plans to pay the Treasury about \$8 billion in principal and interest.

BPA's financial policy is to set its rates to assure a 95 percent probability of making its Treasury payment in each two-year rate period. Because BPA must offer its products and services at competitive prices, it is motivated to vigorously control costs and also to take greater risks

with the Treasury payment. While BPA policy remains a 95 percent probability of paying the Treasury, the initial rate proposal for the 1997-2001 rate period results in a probability of about 71 percent over the five-year rate period. Part of this change in probability is the result of using a five-year rate period rather than a two-year period.

BPA recognizes the need to review its financial policy as its role in the electric utility market evolves. Central issues in this adaptation are likely to include the level of BPA's debt, the probability of Treasury payment, use of revenue financing for capital investments and sources of capital for each of BPA's business lines.

Capital Investments

BPA faces increasing demands for capital investment to ensure that the transmission system

can meet changing regional needs, to replace aging facilities, and to expand investments for environmental protection and fish and wildlife. Yet the sources and amount of BPA's capital financing ability are strictly limited by law.

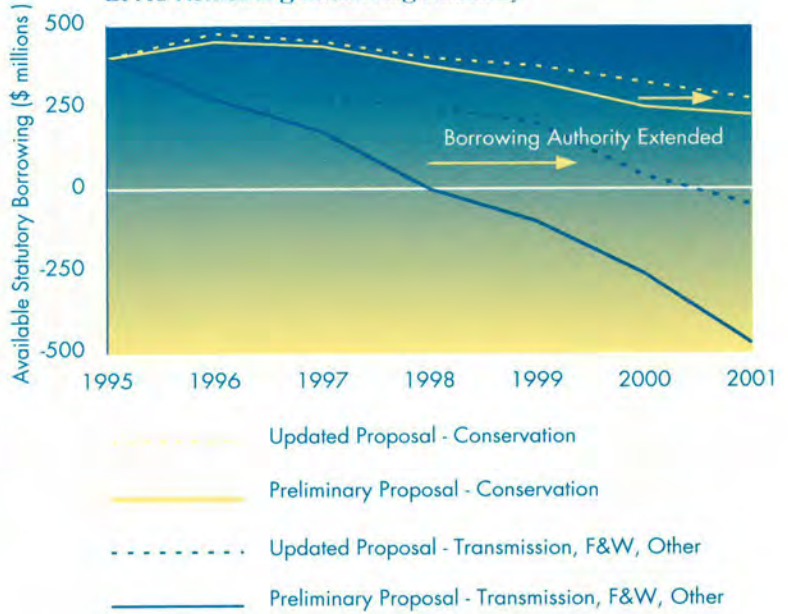
BPA is instituting a comprehensive, agency-wide process to allocate investment capital. This new capital decision process, while still in its infancy, will allow BPA to choose a portfolio of investments that enables BPA to meet its business objectives while controlling debt-related costs by staying within the limits of its capital borrowing authority. BPA will make investments only when financial and economic analyses demonstrate an adequate rate of return after addressing the specific risks associated with the investment.

Debt Management

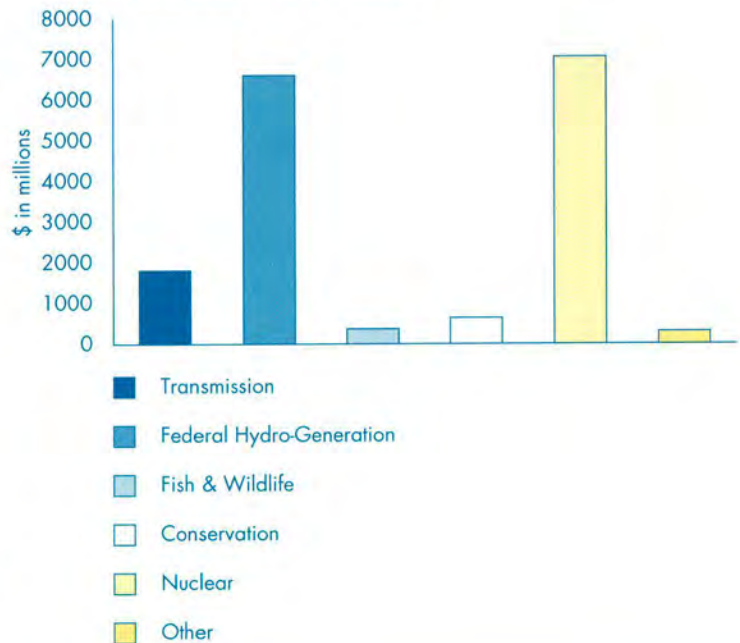
BPA's high debt is a significant financial burden, limiting its financial flexibility and therefore its competitiveness. This includes significant amounts of debt for nuclear generating projects, including four terminated plants. (In 1996, debt service for BPA's net-billed nuclear projects totalled about \$530 million, of which nearly \$330 million was for terminated plants.) BPA is obligated to pay these debts according to current laws and accounting and financial standards. Payments to the U.S. Treasury each year are made only after BPA has paid all of these and other obligations.

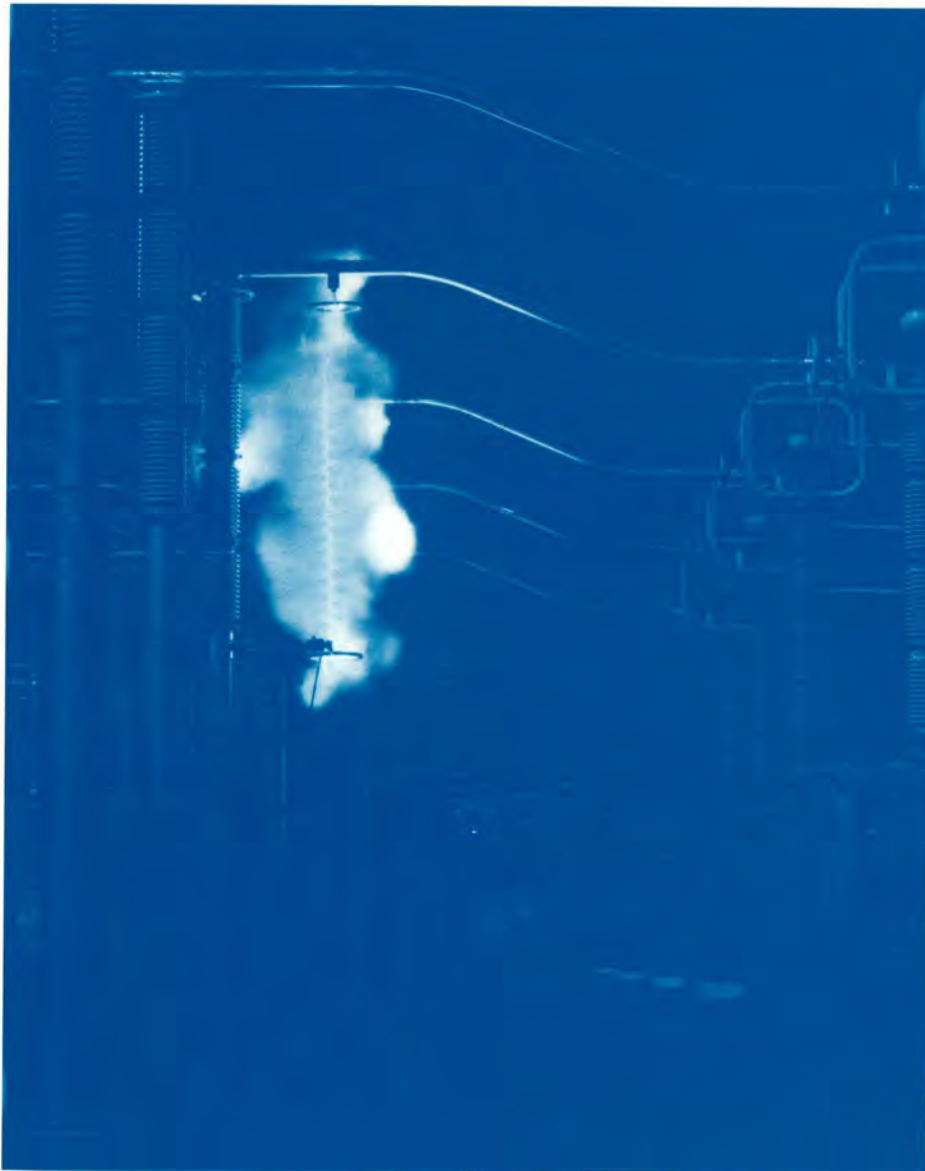
BPA will minimize debt service costs using traditional and new debt management tools and techniques. This includes prudent management of Treasury debt within the caps on Treasury borrowing. Structure and timing of refinancing debt will take advantage of alternative financial instruments and market conditions.

How Reduced Capital Investments Have Extended BPA's Remaining Borrowing Authority



Outstanding Debt - FY 1994





Sources and Adequacy of Capital Funding

BPA will develop and maintain diversified sources of capital that are cost-effective and reliable to ensure that BPA has the ability to fund its capital investments on a timely basis. This will include a comprehensive funding plan that relies on a mix of funding sources, including revenue financing and, potentially, third-party borrowing.

Risk Management Strategy

BPA must anticipate certain types of risk. *Operating risks* are posed by normal fluctuations in costs and revenues, such as the changes in nonfirm revenues from one year to the next caused by variations in the total runoff. These are the risks for which BPA's Treasury payment probability methodology (discussed above) was created. *Catastrophic loss* and extraordinary event risks differ

from operating risks in that they arise from one-of-a-kind events, and may have large impacts on BPA's financial reserves. BPA relies on a combination of specific insurance policies and, when appropriate, the Federal Judgment Fund for protection against these risks. BPA internalizes the remaining risks.

In the last few years two additional types of risk have begun to present serious dangers to BPA: marketing (or sales) risks and risks of structural change. The increasing market risk is due to the rapid increase in the number of suppliers of electricity. BPA risks losing sales to these other suppliers and risks pricing its products too high (causing lost sales) or too low (reducing revenues). Risks due to changes in the structure of the industry show up in the financial exposure

BPA faces when, for example, contracts for power sales or energy resources, written before the market began to change, are to be fulfilled in the new competitive market. BPA is beginning to develop strategies and guidelines for dealing with both of these increasingly prominent types of risks.

Options and futures contracts are fairly recent additions to the risk-management arsenal in the electric industry. Like other utilities, BPA is exploring the potential of these tools for cost-effective management of risks and is beginning to put policies in place for their use. For example, hedging would allow BPA to protect itself against loss in the event of price fluctuations in commodity prices, especially aluminum, which affects BPA through its power sales to aluminum smelters. In effect, BPA would be buying price insurance by paying a third party to accept the revenue risk of changes in the price of aluminum. BPA would be assured of the planned revenues based on the average rate, reducing revenue fluctuations from year to year.

BPA may have a key role in West Coast futures trading. The California-Oregon border is an important market center — or hub — for energy transactions throughout the Western U.S., and BPA is strategically placed to provide support services for this hub. Such services could include power transfers, wheeling and transmission, storage, communication and administration (e.g., scheduling). BPA is working to promote this hub as an aggregation and distribution center for electricity futures trading.

4. Management and Organization

An essential tool for competitive success is an effective and efficient organization. BPA is engaged in a continuing process to ensure that it has the structure, the skills and the motivation to perform successfully in the new competitive market.

BPA'S Position before the Business Plan

Like many government agencies, as BPA's sales expanded and its missions grew over the years, it evolved into a large hierarchical structure with five or more layers of management between line workers and the chief executive. Decision-making tended to be centralized, based on time-consuming briefings, reviews and approvals.

BPA had no staff directly focused on customers. Although field staff often provided a helpful point of contact, customers were faced with a shifting set of contacts within BPA depending on the type of issue they raised.

The organization had become overgrown, with the equivalent of 3,500 full-time employees, supplemented by a large budget for contractor support. The sheer size of the operation, with its focus on internal issue resolution, was an impediment to responsiveness.

Challenges

Customers were dissatisfied, contending that BPA was bureaucratic and oriented towards process rather than results.

Rapid changes in the market demanded quick reactions that were virtually impossible with such a large organization and such bureaucratic decision-making processes.

Employee morale was low due to uncertainty about BPA's future and frustration with BPA's complex and cumbersome internal processes.

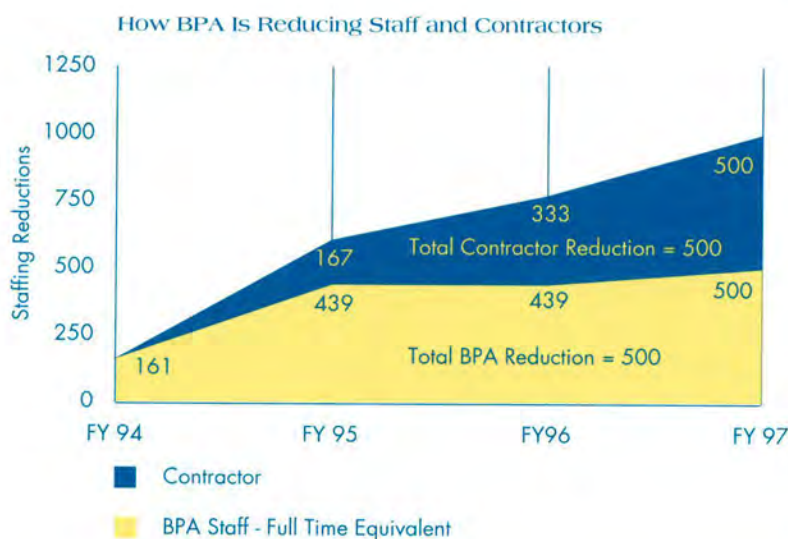
Actions BPA Has Taken to Meet the Challenges

BPA has taken decisive steps to reorient its organization to be responsive, flexible and competitive. The new organization is smaller, flatter and directly focused on customer service and results. The reorganization is renewed by continuing efforts to improve processes and build a corporate culture that can continue BPA's tradition of excellence.

Downsizing and Streamlining

BPA is reducing regular and contractor staff by at least 1,000 full-time employees. BPA expects to meet this target in 1997 and by early summer 1995 was 75 percent of the way to its goal. Reductions have been achieved through voluntary separation incentives and attrition. If

these programs are not sufficient to meet the reduction goal, BPA will seek further flexibility from the Administration in shaping its work force. In keeping with its goal of transforming BPA into a high-performing organization, BPA plans to complete this downsizing process without a disruptive involuntary reduction in force.



Reorganization for Business Orientation

A key purpose of the reorganization is to focus BPA's attention on the customers and constituents BPA serves. BPA has been reorga-

BPA's New Market-Oriented Organization

If a single change exemplifies BPA's new direction it is the formation of top level sales and marketing staffs. The new structure is built around close relationships with customers and up-to-date information about the market.

BPA's sales organization was created to forge strong new relationships with customers. The heart of that organization is a team of customer account executives, who give each customer an individual point of contact and ensure personalized service. Each account executive is empowered to make decisions so that BPA can respond quickly to customer needs. Many customers have already said they are pleased with the new organization and with the service they are receiving from their account executives. Recent survey results indicate that the percentage of customers who are satisfied with BPA overall has increased 7 percent since the Competitiveness Project began. These results demonstrate that, while there is still much room for improvement, BPA has turned an important corner in increasing customer satisfaction.

The sales group works closely with the marketing group. The marketing group conducts market research and collects data to track both customers' activities and to provide a solid information base for market-driven decisions. This group will help refine BPA product definition and pricing to determine costs and establish margin targets. It also will focus on assessing the market to determine which innovative products and services should be provided and when. BPA's new marketing organization is already breaking new ground in product design and margin management.

nized for flexibility and responsiveness to customer needs to increase customer satisfaction. The new organization includes sales and marketing groups that focus on providing highly personalized customer service, understanding the wholesale utility market and developing innovative products and services to serve that market. Customer and constituent account executives provide personal service at the local level. As BPA gains clarity about future market structure and experience with the new organization, there are likely to be further structural realignments.

Re-engineering Systems and Processes

BPA continues to examine how it does business — its systems and processes — and, where necessary, to redesign those functions for maximum efficiency and zero redundancy. The "re-engineering" effort builds on a "function-by-function review" conducted early in the Competitiveness Project. At that time, BPA focused on how its staff should be organized for maximum efficiency and looked at broad processes. Re-engineering focuses closely on how things are done, rather than on people, and examines systems and processes in detail. BPA's re-engineering effort is a continuing process to find opportunities for improved efficiency. The first business process to be re-engineered is the newly-established sales and marketing process.



Reinforcing a Healthy Internal Culture

To ensure high performance, BPA is working to ensure its “culture” — employee behavior, attitudes and norms — supports success and thrives in the new competitive climate. The new BPA aims to build a corporate culture that places high value on teamwork, collaboration, initiative, shared goals, individual accountability and commitment to customer service. BPA employees will be broadly supported in creatively meeting customers’ needs and

BPA’s Leadership EDGE Foundation for a High-Performing Organization

As part of its Competitiveness Project, BPA established Leadership EDGE (Employee Diversity, Growth and Empowerment). Its goals are: to engender a feeling of employee ownership; to create mutually beneficial customer and client relationships within and outside BPA; and to foster work force excellence.

If employees are to feel as though they own BPA, they need to understand the connection between their jobs and the business services they provide. They need to be conscious of costs so that they will strive to use resources prudently, and they need to feel motivated to continually seek better ways to meet their customers’ needs.

BPA employees will be responsible for creating mutually beneficial working relationships with external customers or stakeholders and internal clients. By understanding customer needs, they will produce valued products and services and find innovative ways to meet those needs with available resources.

To foster excellence in BPA’s work force, Leadership EDGE will cultivate “learning managers” and “learning employees.” Managers will focus on strategic direction rather than technical work. Employees will assume responsibility for technical work and results, and work with managers to clarify in their assignments to enhance BPA’s success. Employees’ assignments will allow them to grow and achieve their potential in an atmosphere that reinforces trust, competence and self-confidence. Managers and employees will work for constructive change, continuing system and process improvements, removing barriers to productivity, problem-solving and two-way communication. BPA will foster excellence through a healthy work environment built on fostering mutual respect, valuing diverse perspectives and encouraging individuality.

mastering the market to keep BPA ahead of the competition. These renewal efforts are especially critical for BPA now because the changes of the past year and market uncertainties have impacts on employee morale.

Program Reinventions

BPA is reinventing its fish and wildlife and conservation programs to emphasize better results, cost-effectiveness and efficiency. The fish and wildlife program is being reoriented to establish priorities, provide stable funding and emphasize monitoring for results. The conservation program reinvention retains BPA's commitment to meet regional energy savings goals, but moves the focus from BPA incentive-based, centrally controlled programs to support for individual utility conservation programs that are locally oriented. Earlier conservation programs were designed for an era when there was no infrastructure for conservation or limited understanding and acceptance of the value of conservation.

Fish and Wildlife Program Reinvention

BPA funds the largest program in the world to save a biological resource. In 1995, BPA expects its investment in fish and wildlife to be over \$400 million; in 1996, over \$450 million. BPA's fish and wildlife costs fall under three categories: 1) foregone revenues and replacement power purchase costs; 2) reimbursable capital and expense paid to other agencies; and 3) fish and wildlife program costs.

BPA is reinventing its fish and wildlife program to better ensure that this unparalleled investment is effective in achieving its goals. BPA's customers and the agencies implementing BPA-funded fish and wildlife measures have been concerned that past funding and contracting mechanisms did not provide adequate safeguards to make sure that the money spent would lead to the protection and mitigation of fish and wildlife. An audit by the Inspector General for the U. S. Department of Energy recommended simplified decision-making, closer monitoring and evaluation of projects, competitive bidding and enforcement of performance standards.

In response to these concerns, BPA has reviewed its fish and wildlife program, and is taking the following steps to better assure that the program achieves its intended results:

Setting priorities. BPA is working with the Northwest Power Planning Council and the region's fishery agencies and tribes to set priorities for funding fish and wildlife measures. The process would rank projects based on measures established by the Council in consultation with the region's fishery agencies and tribes.

Stable funding. BPA is committed to providing stable funding each year for BPA's direct program and the reimbursable activities of other agencies, and is working with affected parties to achieve this goal.

Monitoring and evaluation. BPA and sponsors of individual projects are identifying specific intended results for each project, and BPA and the Council will monitor progress to verify that intended results are achieved. New contracts and many existing contracts include monitoring and evaluation requirements.

Ecosystem management. BPA is joining with fish and wildlife agencies in developing and implementing an ecosystem management approach to regional fish and wildlife activities.

BPA expects that the combination of these efforts will maintain progress toward enhancement of the region's fish and wildlife resources, while achieving better results and reducing customers' concerns about uncertainty in BPA's obligations for fish and wildlife costs.

Energy Conservation Program Reinvention

With a total conservation investment of approximately \$50 million annually, BPA remains committed to meeting its share of the regional conservation targets set by the Northwest Power Planning Council in its regional power plan. In response to many customers' requests, BPA is moving away from incentive-based, centrally controlled conservation programs to an approach that supports utilities in setting up their own programs.

Under BPA's reinvented conservation program, the regional conservation targets for BPA's loads, as established by the Northwest Power Planning Council, will be achieved primarily by:

- ▲ independent utility programs; supported by
- ▲ BPA demand-side management products and energy services; and
- ▲ BPA investments in market transformation activities.

BPA's customers will achieve much of the expected conservation under the reinvented conservation program through independent, locally-controlled conservation programs. These local programs will be supported by energy services available from BPA. Market transformation initiatives will help make new energy conservation technologies available and part of common practice. BPA will invest approximately \$15 million per year in market transformation efforts in collaborative ventures with regional and national organizations to move the marketplace toward more energy-efficient products and practices. For example, BPA is a sponsor of the national "golden carrot" energy efficient refrigerator program, and is a partner in the Lighting Design Lab, the Electric Ideas Clearinghouse and other regional conservation efforts. Future market transformation efforts will build on this foundation.

A survey of BPA's customers indicates that utility programs currently planned will continue to acquire regional conservational resources. If these efforts fall short of the regional goal, BPA will initiate additional conservation actions to make up the difference.

Initially, BPA planned to employ a tiered rate structure to provide marginal cost price signals to encourage investments in energy efficiency. With marginal costs now close to or below BPA's rates, it is not useful for BPA to adopt a tiered rate structure at present.



5. Legislative Initiatives

BPA is a creation of Congress, and from time to time Congress enacts legislation to refine or modify BPA's operations. Typically, these legislative proposals relate to the balance between BPA's business activities and its public service missions.

BPA's Position before the Business Plan

Topics of frequent concern before Congress have been the status of the debt for the Federal Columbia River Power System, and BPA's relationship to the Department of Energy.

Periodically, members of Congress or officials of executive departments have noted that some of the debt on the federal power system in the Pacific Northwest is at interest rates below current market rates. Typically, the concern is that the applicable rates are artificially low and that these low rates give an unwarranted advantage to consumers in the region compared to the rest of the nation. Over the past decade, there have been a number of proposals to raise interest rates closer to current market levels.

Although BPA has a considerable degree of autonomy, as a federal power marketing agency, it is also part of the federal Department of Energy, which means that BPA must follow all of the rules and procedures of the Department as well as those that apply to the federal government generally. Some of these governmental requirements do not fit well with BPA's business needs, leading to duplicative reporting or additional paperwork.

Challenges

The advent of competition highlighted issues affecting BPA's costs. BPA supported legislation to change BPA into a government corporation to save the costs of duplicative or unnecessary procedures. On the other hand, proposals to alter the terms for payment of FCRPS debt threatened to significantly increase BPA's costs of debt service and further burden its efforts to compete in the new wholesale power market. As the magnitude of the competitive challenge has become clearer, legislators have put forward other proposals affecting BPA's costs and competitiveness.

Legislative Proposals to Meet the Challenges

A number of initiatives are now under consideration in Congress to improve BPA's competitive position, apart from the strategies laid out in this Business Plan. These initiatives generally depend on new legislation or Administration approval. Because BPA cannot control the outcome of these processes, BPA is not depending on these as strategies for ultimate success, although they will certainly contribute to BPA's competitiveness.

Debt Refinancing

Congress currently is considering a bill that would allow BPA to refinance its pre-1974 appropriated debt, which now has an average interest rate of under 4 percent. Under the refinancing proposal, BPA would be allowed to refinance the net present value of existing appropriated debt through the U.S. Treasury at current market rates (approximately 7 percent) plus a \$100 million refinancing fee. This proposal, which has the support of the Administration, would have a rate impact of less than 1 percent annually.

Should the legislation pass, it will end a major uncertainty about future BPA rates. The current legislation is the first debt refinancing proposal that would not have a major economic impact on the Northwest. Previous proposals have called for debt refinancing arrangements that would have had double-digit rate impacts.



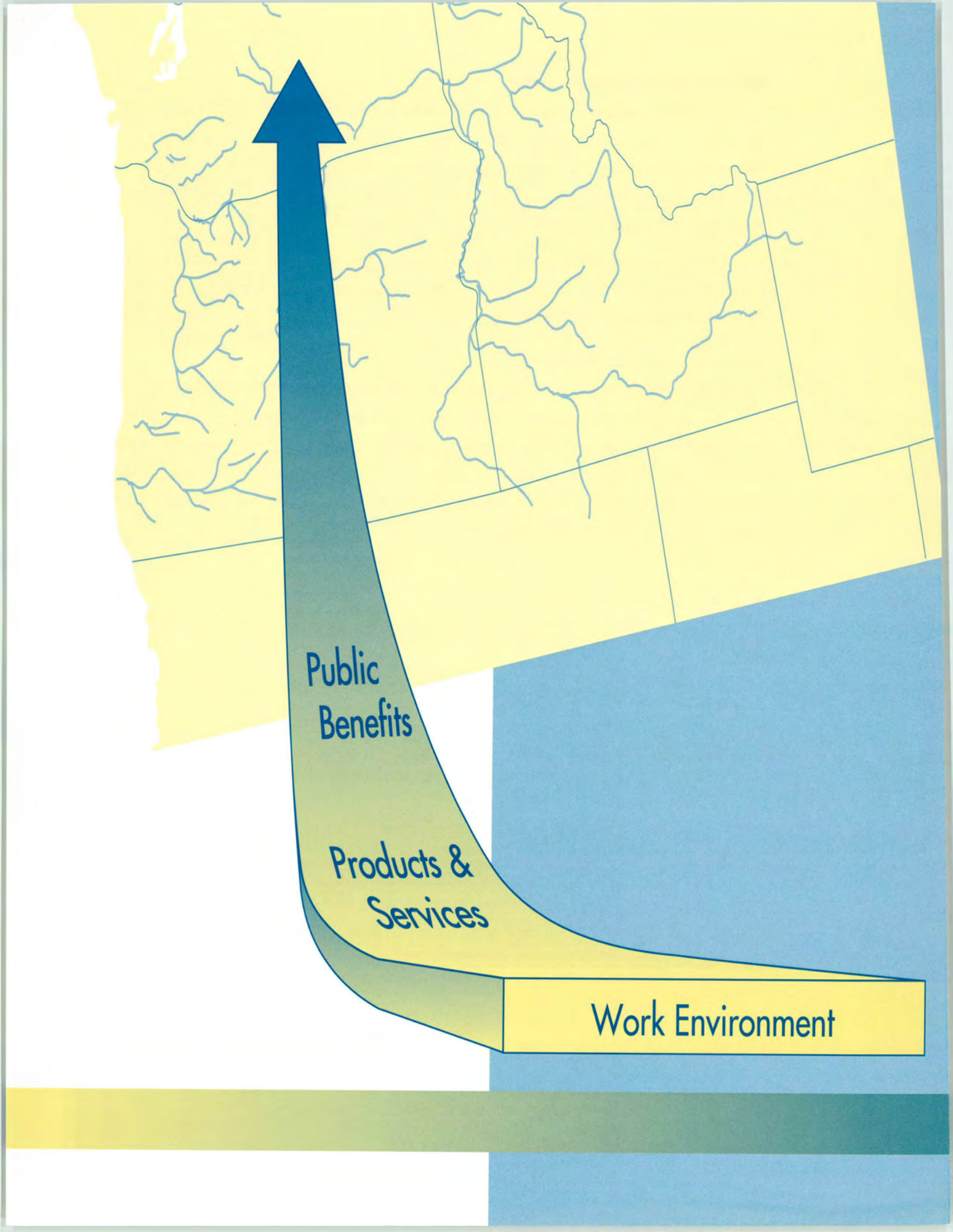
Government Corporation Status

Legislation has been drafted but not introduced that would formally establish BPA as a government corporation. The proposed legislation has a narrow focus that largely addresses BPA's administrative and legal processes, such as record-keeping requirements, hiring, firing, procurement procedures, rights to legal self-representation and ability to enter into binding arbitration. It does not alter BPA's mission or BPA's accountability to the region.

Government corporation status would permanently free BPA of a number of administrative processes designed for appropriated government agencies and would allow BPA to be more flexible and responsive in the marketplace.

Potential Competitiveness Legislation

Both the Administration and Congress continue to be sensitive to BPA's competitive position in the market and to the impacts of open-ended escalation of fish and wildlife costs. Customers and potential customers have cited uncertainty about these costs as a major reason for looking to other suppliers. Many proposed solutions, such as tying fish expenditures to BPA power revenues or allowing BPA greater flexibility in extra-regional sales, would require legislation, and these possibilities are under active discussion.



Public
Benefits

Products &
Services

Work Environment

Only an exceptional organization could conquer the multifaceted challenges that confront BPA. A renewed and supportive work environment must be the catalyst for expansion of products and services to fulfill BPA's potential for benefiting the Pacific Northwest.

V. The Foundation for Success

Fortunately, BPA has unique advantages. Even with some anticipated near-term firm load loss, there are other marketing opportunities that BPA can develop to carry on its public service mission. Even with new fish-driven operational constraints, the output of the federal power system is a major energy resource that makes BPA a key player no matter what the market does. The system's ability to store power and respond quickly to capacity needs provides flexibility unmatched by any thermal system. BPA enjoys long-term sustainability of production capability, ready access to resources and markets, and technical leadership and experience.

The regional transmission system is another major advantage. Like any other transmission user, BPA can benefit from the access that the system provides to energy resources and markets. The extensive 500 kV network within the region and strong interregional connections provide wide-ranging access to marketing opportunities, and cannot be replicated.

With transmission access and hydropower flexibility, BPA is especially well-situated to participate in the competitive electric energy market. BPA's scheduling capabilities, and marketing experience give it the tools to be a "diversity broker," matching needs with opportunities; for example, using DSI loads to accommodate night energy returns or to provide system reserves. The fact that BPA sets standards of quality for system operation puts it in an ideal position to be a "niche" supplier of high reliability, high power quality and special-needs load services.



BPA has been at the forefront of research, development and demonstration and continues to advance utility industry technologies. BPA is experienced in anticipating future needs and taking the necessary steps to meet those needs. With the region's strongest technical foundation, BPA has a solid basis for becoming an energy service provider and offering diverse services to current and new customers.

Most of all, BPA has the advantage of its employees. Time and again the people of BPA have proved that they have the ability, knowledge and the dedication to do whatever it takes to build a better future for the Pacific Northwest.

Conclusion: The Bottom Line

These advantages, combined with BPA's new initiatives, should make clear BPA's commitment to thrive in a competitive world. BPA is not simply dedicated to its own success as an organization, but rather to be a major part of the region's success. BPA will continue to champion the mandates of widespread use of the federal power, environmental mitigation, energy efficiency and renewable energy resource development. This commitment to serve these public benefits should be evident from the tough decisions BPA has already made.

Faced with the challenge of competition, BPA has made bold new marketing proposals to meet the needs of its customers, while at the same time it has reorganized and drastically reduced costs and staff. There have been no sacred cows. Long-standing plans and relationships have been re-examined and revised as necessary to fit the times. These actions were taken to ensure competitive pricing in the marketplace and to keep faith with BPA's most important partners — its customers.

One final message bears repeating. While this Business Plan has focused on strategies and actions to succeed in a competitive marketplace, it should be underscored that the need to succeed is driven by a fundamental purpose. The bottom line is BPA must succeed as a business so that it can succeed in fulfilling its stewardship missions for the citizens of the Northwest.

For more information

If you would like additional information on the Business Plan or related issues, please contact your account executive or one of the following BPA Offices:

Public Involvement	(503) 230-3478 (800) 622-4519
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