Department of Energy

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FINANCE

May 23, 2014

In reply refer to: F-2

To Customers, Constituents, Tribes and Other Stakeholders:

Thank you for your participation in the 2014 Capital Investment Review (CIR). In February, we began the CIR to provide interested parties an opportunity to review and comment on our long-term capital investment forecasts, draft asset management strategies and methodology for prioritizing capital investments. We found the comments and recommendations received to be insightful and very useful. In this letter, we want to summarize our planned capital spending levels and respond broadly to key areas of comment.

During our Kick-off Meeting on February 21st, we stated our five objectives as: 1) preserving and enhancing the assets and value of the generation and transmission system, 2) expanding balancing capabilities and resources, 3) advancing energy efficiency and meeting our endangered species responsibilities, 4) providing an open access transmission system, and 5) optimizing Bonneville Power Administration's (BPA) investment portfolio. The comments we received will help us advance these priorities.

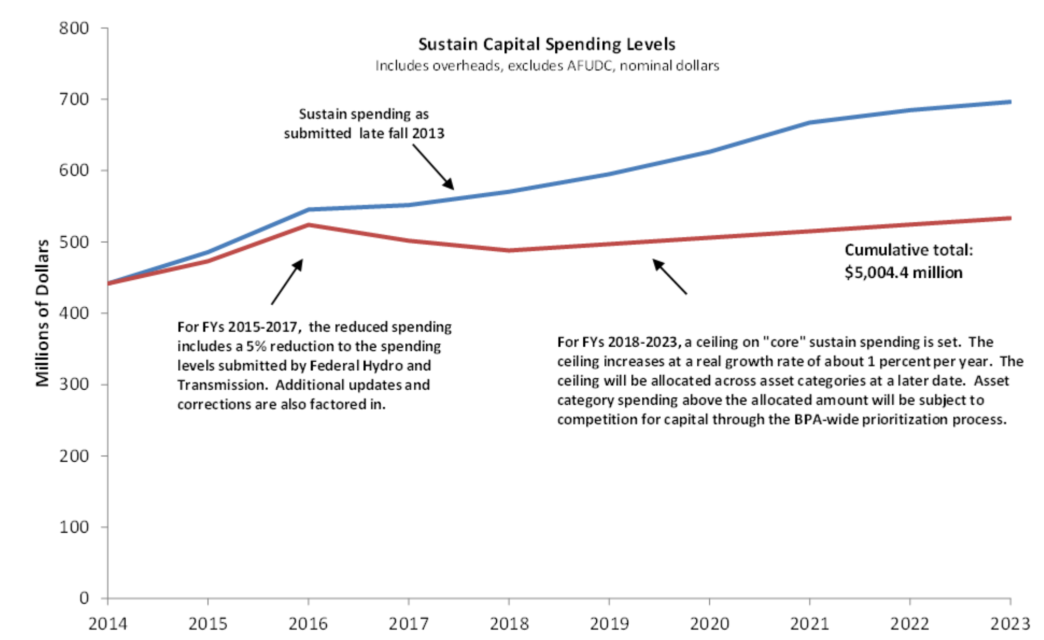
We wholeheartedly agree with recommendations that we manage our costs to be able to provide low, stable, and highly competitive rates over the long-term. The CIR, together with the upcoming Integrated Program Review (IPR), is the beginning of a dialogue on our long-term asset and financial strategies and rate objectives. We are developing our long-term financial and rate forecasting capabilities to support this dialogue.

To move forward with IPR and Debt Management workshops, we will be adopting the upper-end of the cap range on capital spending that was proposed in the CIR. However, we are open to on-going strategic discussions about BPA's cost structure and long-term investment levels. We will accept additional comments on capital spending levels during the IPR comment period (comment period ends July 1st) and may conduct an IPR 2 early next spring to reflect outcomes from long-term strategic discussions with stakeholders prior to setting rates, including outcomes from Energy Efficiency's Post-2011 Review.

A top priority of ours is to preserve and enhance the economic, environmental and operational value of the federal power and transmission system. For over 70 years, the Northwest has benefitted from the engineering genius of those who designed and built the federal power system and transmission grid. However, both are currently being operated in ways its designers could not have envisioned and BPA must invest strategically to meet evolving demands and optimize the region's supply of affordable, clean, and reliable power, and sustain the long-term value of the federal power and transmission system.

Today, our power and transmission assets are aging, and we face the challenge of modernizing and positioning the system for another 50-75 years of success. This requires us to examine not only near-term spending levels but also long-term priorities and trade-offs as well. We believe these challenges must be met through innovation and cooperation throughout the region.

Efforts to modernize critical assets began ramping up several years ago, with capital spending for value-sustaining activities growing from approximately $205 million in FY 2008 to approximately $435 million in FY 2013. We plan to continue the higher rate of "sustain" spending, but with the pace of growth held to slightly above the rate of inflation for the foreseeable future.



Simply modernizing and replacing the existing asset base will be insufficient, however. New capacity and capabilities are needed as well to serve loads, bolster reliability, integrate new generation, and improve operating efficiency.

Two years ago, we began a leading practice-based approach to prioritizing investments. The new prioritization process seeks to optimize the investment portfolio while recognizing rate, capital, labor and other constraints. To date, the new process has been directed at prioritizing large projects that add new capacity and capabilities. The first results of the process were presented during the CIR, and BPA will be extending coverage to additional investment types in the future, such as small expansion investments (expansion projects costing less than $3 million), as many of you have urged.

A key component of our proposal in the CIR is a cap on capital expenditures for the 10-year planning horizon. The cap's purpose is to bring long-term "affordability" factors into the decision process when capital budgets are set but there appeared to be some confusion regarding the cap's objectives. The level at which the cap is set is a matter of risk-informed judgment about rate implications, the availability and use of various sources of capital and other factors. This was our first attempt at applying budget constraints in this fashion and we will continue to refine the methodology. We will revisit the cap prior to the next CIR with more emphasis on rate impacts.

The capital spending levels to be reflected in the upcoming IPR are summarized in the table below. These spending levels reflect no additional reductions from what we initially proposed in the CIR. Recall that we already reduced our proposed spending projections for the FY 2014-2017 period by about $800 million preparatory to the CIR, and by $2.7 billion for the 10-year, FY 2014-2023 period as a whole.

Multiple stakeholders commented on the front-loaded shape of BPA's proposed portfolio and expressed concern that reductions in the out-years would not be realized. Higher spending in the early years of the 10-year period is attributable to major, high-value capital projects that BPA authorized previously and that are underway. Long-term capital discipline is central to BPA's financial and asset strategies and BPA is committed to optimizing its investment portfolio while assuring a low-cost, sustainable capital strategy aligned with stable, long-term competitive rates. We believe we have reduced capital spending as far as we prudently can, and therefore, we are proposing to make no additional cuts to near- or long-term capital expenditures. For the FY 2018-2023 period, the spending levels BPA is targeting comport with the upper-end of the cap range, and will be used as the base case in the upcoming debt management workshop.

Capital Spending Levels - IPR

Nominal Dollars in Millions (Includes overheads, AFUDC and LGIA projects)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
Transmission											
Sustain	313.6	430.4	320.5	236.5	260.8	259.8	269.5	279.1	286.3	290.4	2,946.8
Expansion	217.6	196.3	209.5	231.3	137.8	128.4	102.5	0.8	-	-	1,224.3
Federal Hydro											
Sustain	189.4	189.0	206.2	221.8	257.0	282.0	307.0	332.0	349.0	355.0	2,688.4
Expansion	0.7	11.3	17.9	8.4	-	-	-	-	-	-	38.4
Information Technology											
Sustain	16.0	6.2	11.8	8.4	10.0	5.0	2.5	12.0	4.7	6.5	83.2
Expansion	27.0	25.0	21.0	17.0	-	-	-	-	-	-	90.0
Facilities											
Sustain	5.6	13.9	26.9	18.1	28.1	28.1	28.1	28.1	28.1	28.1	233.3
Expansion	47.1	19.2	21.7	3.1	3.1	3.1	3.1	3.1	3.1	3.1	109.9
Security/Environmental/Fleet											
Sustain	18.5	20.5	18.6	20.6	19.6	22.0	19.2	16.2	16.5	16.5	188.2
Expansion	5.1	4.0	-	-	-	-	-	-	-	-	9.1
Sustain and other undistributed reductions	-	-	-	-	(107.4)	(123.2)	(145.4)	(177.3)	(185.4)	(188.0)	(926.8)
Energy Efficiency	75.2	92.0	94.8	97.6	100.5	103.6	106.7	109.9	113.1	116.3	1,009.6
Fish and Wildlife	50.0	51.8	54.8	30.8	18.6	34.8	35.0	33.6	29.0	29.3	367.8
AFUDC	43.4	52.2	63.2	39.2	38.1	45.0	24.8	26.3	27.1	28.8	388.0
Total without headroom	1,009.1	1,111.9	1,066.9	932.9	766.3	788.6	753.2	663.8	671.6	686.0	8,450.2
Headroom - lower end of cap range	-	-	-	6.0	8.0	10.0	18.0	20.0	20.0	28.0	110.0
Headroom - upper end of cap range	-	-	-	56.0	108.0	130.0	158.0	160.0	170.0	178.0	960.0
Total Capital - upper end of cap range	1,009.1	1,111.9	1,066.9	988.9	874.3	918.6	911.2	823.8	841.6	864.0	9,410.2

The following addresses two additional areas of comment: (1) how BPA should optimize its investment portfolio, and (2) planned funding levels for Energy Efficiency. Several comments were received on the metrics BPA is now using to rank order investments, and on weightings BPA should assign to certain investment types. To clarify our approach for prioritizing investments, we use three metrics. The first metric, Net Economic Benefits Ratio (NEBR), will continue to be used to rank-order investments in terms of their overall economic value. The NEBR is designed to capture the value of investments to the region as a whole, including the value to BPA. The second metric, Net Present Value – BPA Cash Flows, will be used to ascertain the costs and benefits that would flow to BPA. As such, this metric is a BPA subset of the regional NEBR. The third metric, Present Value – Revenue Requirements (PVRR), will be used to estimate the impact of investments on BPA revenue requirements. This metric will be applied to the portfolio of investments as a whole and to the largest investments individually.

The results from the three metrics – plus non-quantified factors such as policy drivers and customer needs – will be considered by BPA when it selects its portfolio. Results from the metrics, together with a summary of decision factors, will be made available to stakeholders through the Quarterly Business Review as BPA refreshes its portfolio on a 6-month cycle.

When prioritizing investments, it is important that the playing field be level and that potential investments be treated equivalently on the basis of their merits. We have attempted to do this. However, as mentioned earlier, we look forward to future improvement and refinement of this methodology, including finding the appropriate balance or weighting between metrics and other relevant factors.

For example, we agree with comments that BPA should be cautious in approving investments that would provide high value to the region as a whole if BPA customers would bear the full costs. The cost burden of investments should be aligned with the benefits that would be received. The methodology we are using helps illuminate all sources of value from an investment. It also helps illuminate who would receive that value. We will use this information in determining whether the beneficiaries should be asked to share in the costs.

Energy Efficiency continues to be a key strategic priority for BPA. Stakeholders and staff have had productive conversations in the Post-2011 Review public process, the CIR process, and in other meetings, which may have implications for capital spending levels by BPA. With issues still being discussed in different forums, BPA will maintain the Energy Efficiency spending levels that BPA proposed in the CIR, but they will be subject to change based on the Post-2011 process and additional discussions with customers, the NW Power and Conservation Council, and other stakeholders.

During the CIR process, it was our goal to engage you in helping us make some hard decisions regarding the many challenges associated with making the needed investments to meet the requirements of an aging federal power and transmission system, while maintaining low rates. We hope you found that engagement productive and useful.

Thank you again for your support and participation.

Sincerely,

/s/ Nancy M. Mitman

Nancy M. Mitman
Executive Vice President and Chief Financial Officer (Acting)

/s/ Cathy L. Ehli

Cathy L. Ehli
Executive Vice President, Corporate Strategy