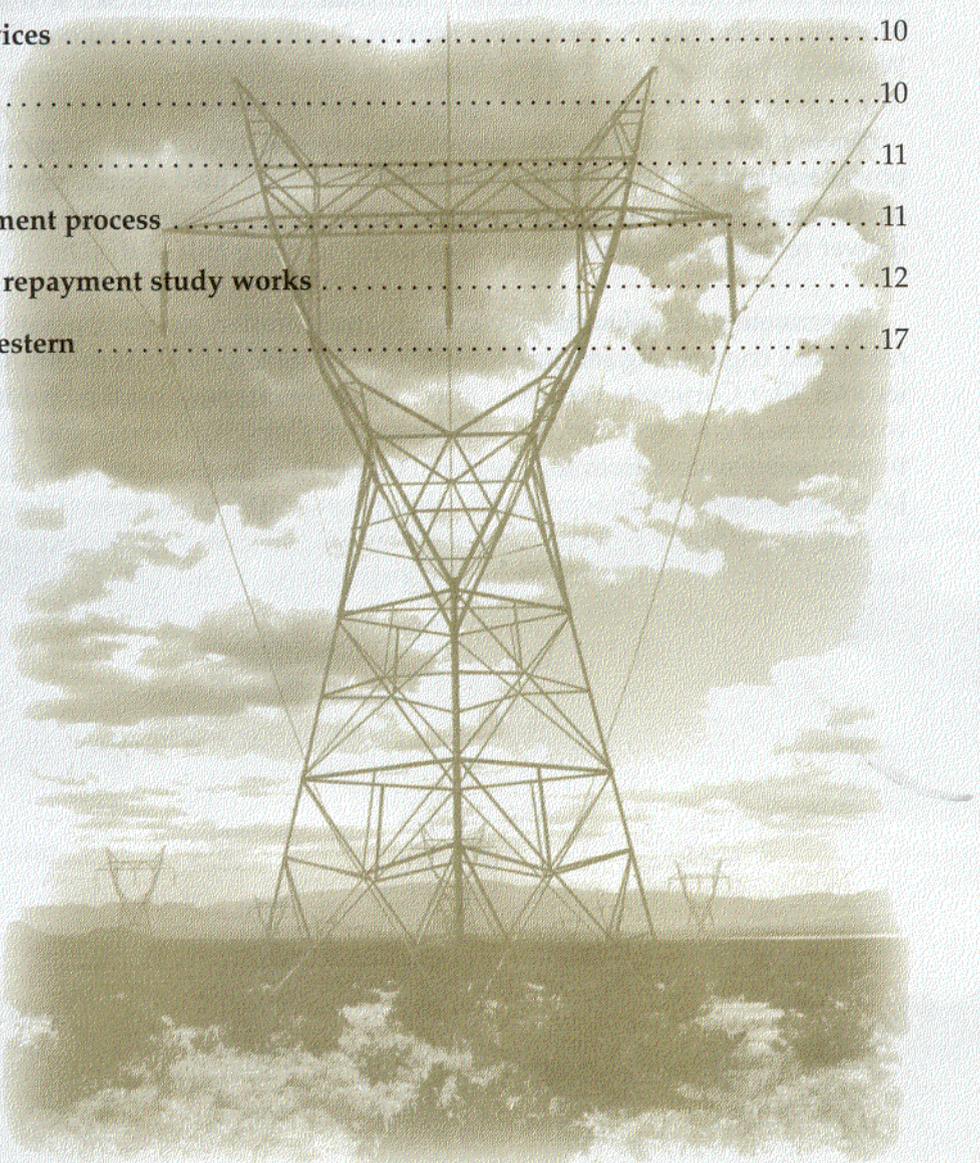

This brochure describes Western's procedures and policies for power ratesetting and repayment in general terms. Detailed information and official policy guidelines for power repayment studies and rate adjustments are available on request.

**For more information about Western, call or write:
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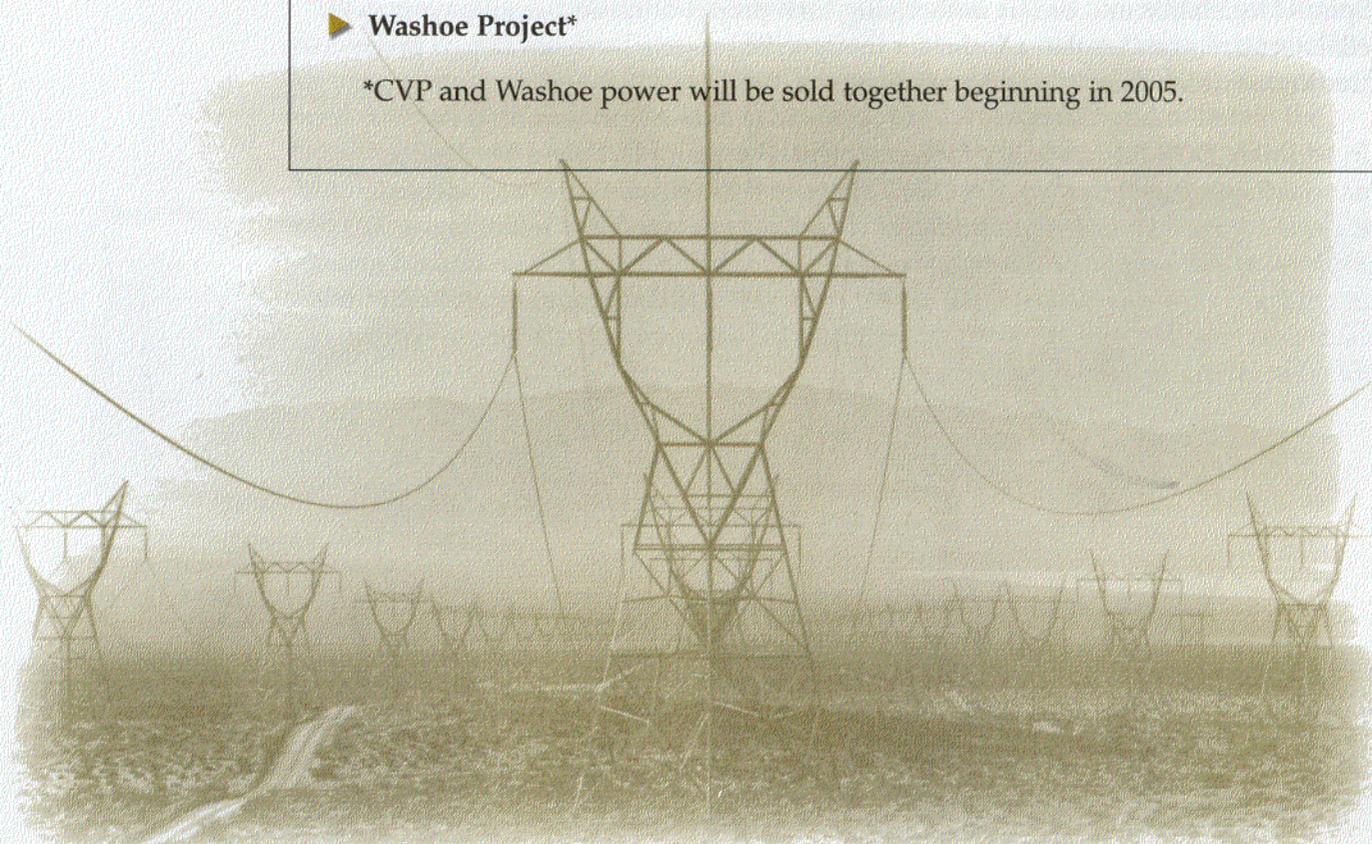
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The 11 rate systems and the projects included in those systems are:

- ▶ **Boulder Canyon Project**
- ▶ **Central Arizona Project**
- ▶ **Central Valley Project***
- ▶ **Falcon-Amistad Project**
- ▶ **Loveland Area Projects (Pick-Sloan Missouri Basin Program—Western Division and Fryingpan Arkansas Project)**
- ▶ **Pacific Northwest-Southwest Intertie (including the Mead-Phoenix Project)**
- ▶ **Parker-Davis Project**
- ▶ **Provo River Project**
- ▶ **Pick-Sloan Missouri Basin Program—Eastern Division (includes, Shoshone, North Platte, Colorado-Big Thompson and Kendrick)**
- ▶ **Salt Lake City Area/Integrated Projects (Colorado River Storage Project, Collbran, Rio Grande, Seedskadee and Dolores projects)**
- ▶ **Washoe Project***

*CVP and Washoe power will be sold together beginning in 2005.



Federal electric power and transmission: services that pay for themselves

ales of Federal electric power and transmission repay all costs associated with generating and delivering that power. Thus, all of Western's costs and the power-related costs of the generating agencies are included in customer rates. While, in general, we receive annual appropriations from Congress to finance our operations, we set power rates to recover all costs associated with our activities, including operation and maintenance, purchase power and wheeling, as well as construction and rehabilitation.

Rates are also set to repay, with interest, the Federal government's investment in building generation and transmission facilities. These rates must also cover certain non-power costs that power users were assigned by Congress to repay. These include irrigation costs that water users cannot repay.

Congress directed that power rates be the lowest possible to recover costs consistent with sound business principles. As a result of this Congressional direction, electric power is one of the few government services that pays for itself.

Western sells wholesale power and provides bulk wholesale transmission service to local utilities, and is not responsible for meeting the demands of retail customers' load growth. Rather, wholesale electric utility customers must supply their retail consumers' total electric requirements by obtaining resources from wholesale power providers like Western, purchases and exchanges from neighboring utilities and their own generation.

Repayment study process

To determine if power rates for each project are adequate, Western calculates how much revenue is needed to meet annual operating and maintenance expenses and repayment requirements. (These calculations are done according to the Reclamation Project Act of 1939 and Title 43 of the U.S. Code.) Western prepares annual power repayment studies to ensure power rates are adequate. Prepared according to the DOE Order No. RA 6120.2, the power repayment study essentially summarizes historical financial data and estimates future revenues, expenses and investments and repayment.

The study includes income from marketing and transmitting power, expenses for purchased power (power that Western must purchase to meet contractual obligations to customers)¹ and transmission costs. It also includes expenses for operations and maintenance, capital investment (including replacements of power facilities) and the annual interest on those investments. Repayment studies also track irrigation costs assigned to power customers for repayment. These costs, determined to be "beyond the ability of irrigators to repay" are called "aid to irrigation."

¹ Purchase power and wheeling are increasingly being funded by specific customers who choose to have Western purchase energy on their behalf, and the costs are not included in the rate base. (However, this does not apply for CRSP customers.)

More specifically, the study details year-by-year projected revenues and expenses, estimated amounts of interest to be paid each year, as well as the total amount of investment to be repaid². Historical data is gathered primarily from accounting records through the last fiscal year. In addition to Western's marketing and billing records, historical and projected figures for generation, hydrology and project data are provided by the U.S. Bureau of Reclamation, the U.S. Army Corps of Engineers and the International Boundary and Water Commission. These agencies also provide hydrological forecasting data used to project resource sales.

Power repayment studies normally use long-term, average generation expected in all future years of the study. However, during high-water years, more revenue than average is available to make additional principal payments. During low-water years, Western incurs additional expenses for purchase power to meet contractual obligations. In this case, estimated principal payments may be reduced or deferred. We are allowed to vary repayment to recognize the water supply's variable nature from year to year, but must meet the repayment criteria set forth in DOE Order No. RA 6120.2.

Projected operating and maintenance expenses are usually based on budget documents. Interest on investments in the repayment study is calculated according to the specific authorizing legislation for each project or Order No. RA 6120.2. Estimated and budgeted costs for project additions and equipment replacement are included. Projected service life on replaceable items is recorded in the power repayment study.

In each repayment study, revenues are applied to expenses according to specific repayment criteria. Annual operation and maintenance costs, transmission charges, purchase power and annual interest expenses are paid first and must be repaid each year. Annual expenses must be repaid in the year the expense was incurred. Annual expenses that cannot be repaid in the same year may be capitalized. Remaining revenues are applied against unpaid capital deficits and investments, such as generation and transmission facilities, and, finally, irrigation costs assigned to power for repayment.

Flexibility: key factor in Western's repayment

Under ideal circumstances, water conditions would remain constant, equipment would be replaced precisely at the end of its service life and operations and maintenance crews would not have to deal with the results of earthquakes, tornadoes, droughts, ice storms and other phe-

² The majority of Western's projects use the balloon payment methodology for repayment of project costs. This means that interest associated with the investment is due annually on the unpaid balance and principal payments for capital costs are not due until the end of their repayment period. For example, if an investment has a repayment period of 50 years, the project can pay interest in each year based upon the unpaid balance and the total principal payment can be made in the 50th year.

nomena that affect generation and transmission system components. Revenues and expenses would remain relatively constant. However, our world is dynamic, not constant. We respond to these changing conditions through our flexibility in repaying the Federal investment in power and irrigation facilities.

For example, annual repayment studies allow Western to determine the revenues needed to meet our statutory requirements of repaying Federal power investments with interest while keeping wholesale hydropower rates as low as possible, consistent with sound business principles.

Using flexible provisions in our power sales contracts, we have the ability to adjust power rates through a public process, in compliance with DOE's Procedures for Public Participation in Power and Transmission Rate Adjustments and Extensions (10 CFR Part 903). Customers can also opt out of their contracts if they don't like the rate change.

Alternative financing methods

Another way we show flexibility is with our alternative finance program. Western finances a significant amount of our purchase power and wheeling program through non-appropriated, alternative financing methods. This means that when Western must purchase power to meet contract terms to customers, we can sometimes accomplish this without asking Congress for financing.

Alternative financing includes bill crediting, which credits a customer's bill when the customer makes a payment on Western's behalf to a Western purchase power and wheeling supplier; net billing, which nets a customer's bill for services performed when Western acquires energy or wheeling from that customer; and reimbursements, which allow Western to use other Federal agency reimbursements for services to offset the cost of providing those services.

Another example is advanced customer funding, where a customer advances funds to Western or a generating agency for capital, operation and maintenance expenses, such as transformer replacements. This reduces our need to ask for Congressional appropriations for these types of projects and ensures timely operation and maintenance of the system.

Rate adjustments and public involvement

Annual power repayment studies determine whether current rates will generate enough revenue to meet repayment requirements. If it does, it can continue in effect or be extended. However, if the rate is excessive or insufficient, we develop a new rate to meet the new revenue requirements. If any adjustments need to be made, Western's administrator may make the announcement directly to customers or through various media, such as newspaper advertisements or news releases. However, they are most commonly announced in a *Federal Register* notice. These policies comply with 10 CFR Part 903.

Typically, we meet with customers before beginning any formal rate process. The next step in the public involvement process begins with a notice in the *Federal Register* about the rate proposal. It describes why the new rate is necessary and estimates the new rate. While we are mandated by law to seek comments from the public on proposed rate adjustments, we value their input. We include opportunities for the public to receive information and provide comments during the rate proposal process.

The *Federal Register* notice about a proposed rate also includes the location, dates and times of any public meetings and an invitation for comments, either oral or written. We allow the public a specific time period, usually 90 days, to gather information about the rate proposal and provide comments.

We normally host two kinds of public meetings concerning rate adjustments. A public information forum involves a formal presentation by Western staff, as well as questions and comments from the audience. After the forum, we provide written responses to questions that require more detailed answers. We hold a public comment forum to allow citizens to voice their opinions and suggestions about the proposed rate adjustment on the public record. We make no presentation at this meeting and do not address questions in the formal portion of the meeting. All comments are considered during the rate development process.

Both types of forums are formal, and normally a court reporter records the proceedings. If public participation leads to significant changes in the proposed rate adjustment, a modified proposal may be published in the *Federal Register* and the public will be given an opportunity to comment on the modifications.

The public involvement process allows citizens to provide input before we make a power rate decision that may affect them. It offers Western an opportunity to understand issues important to the public, as well as to educate the public about our rate development assumptions and data.

We provide background data, studies, reports and other documents used in developing the proposed rate to anyone interested. Additionally, during this public process, Western representatives explain the proposal and welcome suggestions for its modification. Interested people may also submit written comments to Western concerning the proposed rate.

After the consultation and comment period, we review oral and written comments on the proposed rate or revised proposal. All this may lead Western to modify the proposal, which can, in turn, lead to more public participation and comment. Then, Western's administrator develops a final proposed rate. Lastly, this rate is forwarded to the deputy secretary of energy to confirm, approve and place in effect on an interim basis. The authority of the deputy secretary to approve the rate is granted by DOE's Order No. 204-108, (58 Fed. Reg. 59, 716 11/10/93).

Next, we forward the interim rate, all supporting documents and the public record to the Federal Energy Regulatory Commission per FERC's Filing Requirements and Procedures for Approving the Rates of Federal Power Marketing Administrations, 18 CFR Part 300. Commission members may confirm, approve and place the final rate in effect, send it back to Western for further study or disapprove it.



Responding to change

In the 1990s, the electric utility industry experienced tremendous changes in structure. The industry witnessed rapid restructuring as many diverse competitors entered the marketplace to buy and sell power at wholesale rates and as some consumers began choosing their own electricity suppliers. Consequently, these regulatory and structural changes have increased competition to fulfill customers' energy demands.

As a result of this restructuring and competition, Western rose to meet the resulting challenges by streamlining functions and reorganizing. We have become more flexible while maintaining our focus on long-range planning to identify and prioritize major capital expenditures. We want to ensure that we, as part of the Federal power complex, can meet the pressures of the new marketplace.

To accomplish this goal, we have begun restructuring our marketing and transmission functions, assessing available transmission capacity and unbundling services (see Ancillary services on page 10) for new customers to participate in the deregulated environment.

Some changes Western has made were initiated by a set of regulations (orders) issued in April 1996 by the Federal Energy Regulatory Commission, specifically FERC Orders No. 888 and 889. These orders permit competition in the electric utility industry through broader access to transmission systems. The open access transmission rules require utilities to deliver power from other utilities and generation sources to wholesale customers.

Another way we met the challenge was to strengthen our partnerships with generating agencies to manage power delivery costs and to improve power system reliability and efficiency. These efforts have resulted in agreements from customers to provide advance funding for operation and maintenance expenses.

Ancillary services

Ancillary services are services that make the transmission system “work.” They support transmission of capacity and energy from resources to loads while maintaining reliable system operation.

Ancillary services include:

- ▶ **scheduling, system control and dispatch service**—schedules the amount of energy to be delivered, assigning load and ensuring operational security, among other tasks;
- ▶ **reactive supply and voltage control from generation sources service**—maintains correct voltage through adjustments to generator output;
- ▶ **energy imbalance service**—provides energy correction for any hourly mismatch between a transmission customer’s energy supply and demand served;
- ▶ **regulation and frequency response service**—follows the moment-to-moment variations in the demand or supply in the control area;
- ▶ **operating spinning reserve service**—provides immediate back-up service from a reserve unit to serve load in case of a system contingency;
- ▶ **operating supplemental reserve service**—serves loads when a contingency exists; not available immediately to serve load but can be available within a short time.

We develop transmission agreements for these services and may modify them upon written notice to the customer. In some projects, customers can get credit on their power bills if they receive the service from another source or supply it from their own load. If the resources are not available to provide these services, Western will offer to purchase the service and pass through the costs to the customer, plus administrative fees.

Rate targets

We are also committed to limiting increases in annual operating expenses to keep our rates and our customers’ rates competitive. To do this, we are committed to continued management of our costs. We will ensure that we have adequate financial resources to meet or exceed our customers’ expectations. We will leverage our business systems to improve productivity and delivery of products and services. We will control our costs, and thus, our rates.

Consequently, we establish rate targets for each project to assure our rates remain competitive and to establish specific annual cost management goals. We will measure actual rates relative to rate targets.

Our future

Our vision is to be a premier power marketing and transmission organization. Accomplishing this goal will require significant resources, talent, time and sound business decisions. Yet, we know we can meet these challenges by working closely with our customers, suppliers, neighboring systems and others in the industry.

In this era of rapid deregulation and change, we know that keeping our rates competitive and providing superior service to our customers are the keys to our future.

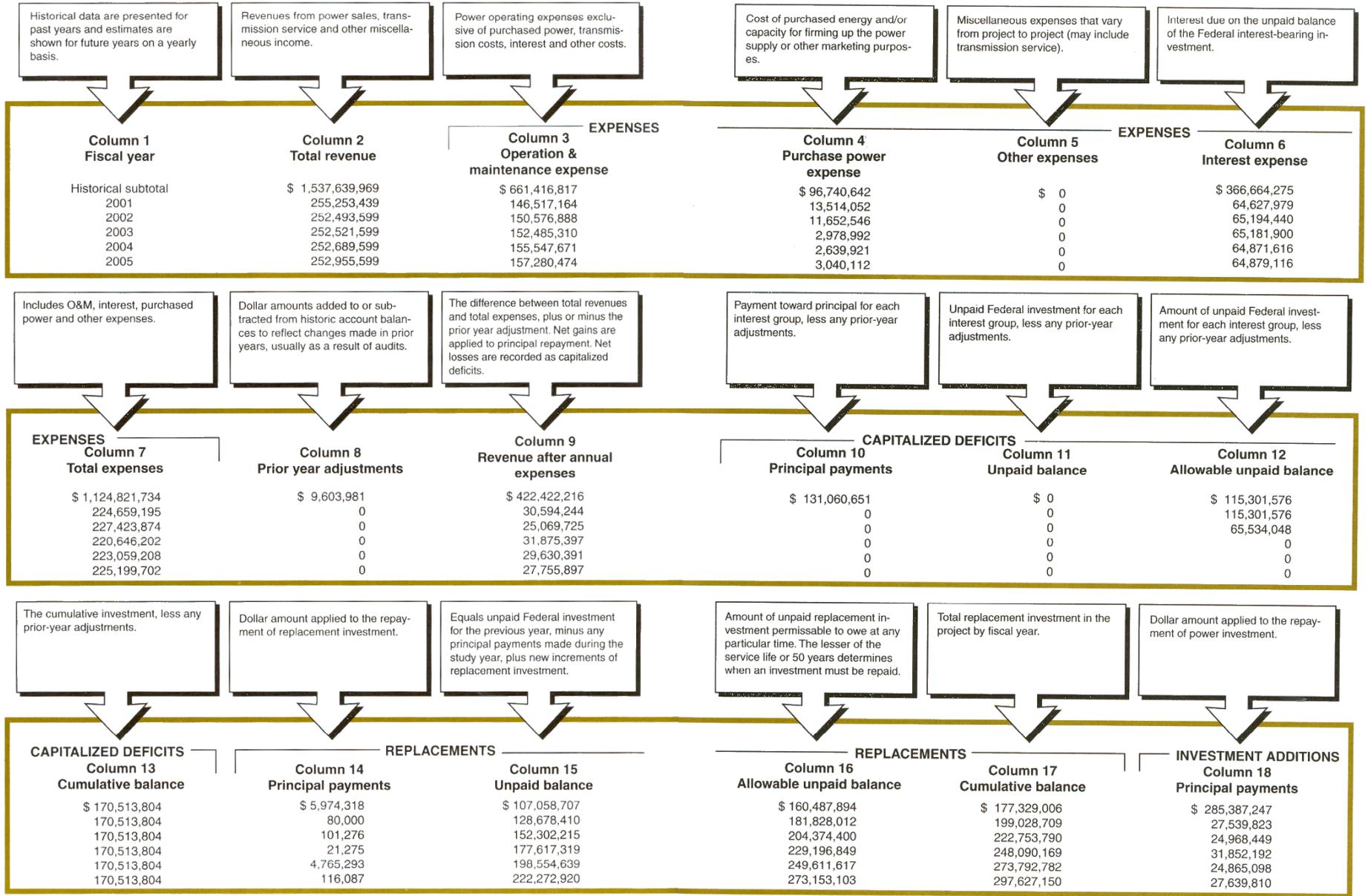
Rate development process

In general terms, the steps below describe how Western develops rates. Specific circumstances, however, may call for modifications. The steps include:

- ▶ Annual power repayment study run to determine revenue needed.
- ▶ Detailed cost studies and proposed rate design completed.
- ▶ Informal meeting to discuss initial rate proposal.
- ▶ *Federal Register* notice announcing a rate process.
- ▶ Formal public information forum held to explain proposed rate; comments requested.
- ▶ Formal public comment forum held.
- ▶ Public comments reviewed and considered.
- ▶ Final rate reviewed and proposed by Western's administrator.
- ▶ Proposed rate placed into effect on an interim basis by deputy energy secretary.
- ▶ Final proposal submitted to FERC for confirmation.

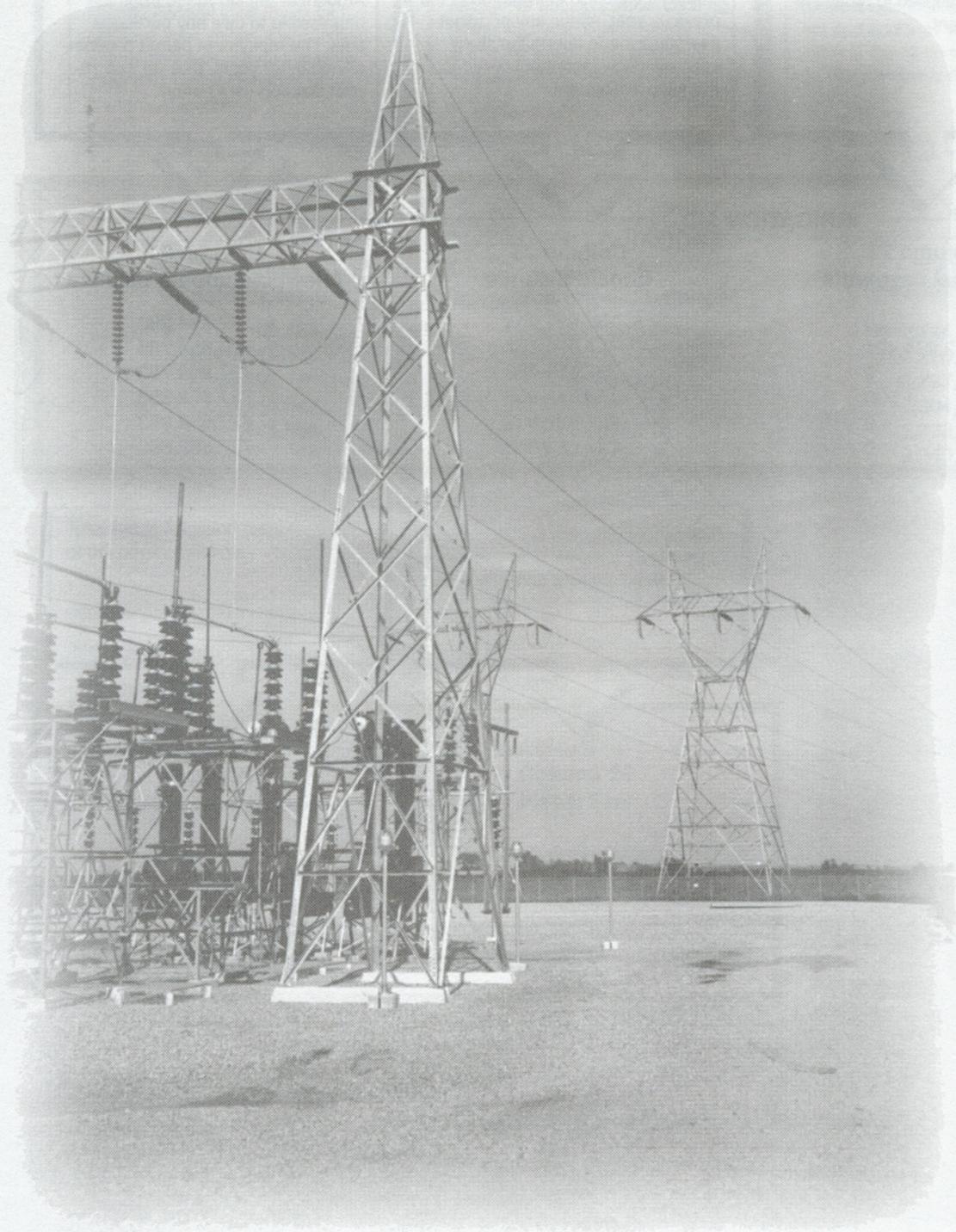


How a Power Repayment Study works



INVESTMENT ADDITIONS			IRRIGATION AID		
Column 19 Unpaid balance	Column 20 Allowable unpaid balance	Column 21 Cumulative balance	Column 22 Principal payments	Column 23 Unpaid balance	Column 24 Allowable unpaid balance
\$ 1,127,365,728	\$ 2,132,739,064	\$ 2,244,391,193	\$ 0	\$ 730,629,204	\$ 732,894,080
1,125,645,476	2,150,325,081	2,270,210,764	2,974,421	727,654,783	727,654,783
1,118,266,796	2,153,667,018	2,267,900,533	0	727,654,783	727,654,783
1,103,340,070	2,149,026,435	2,304,725,999	1,930	727,652,853	727,652,853
1,097,421,969	2,113,981,113	2,323,672,996	0	727,652,853	727,652,853
1,086,363,360	2,049,625,236	2,340,254,197	0	727,652,853	727,652,853

IRRIGATION AID	Column 26 Fiscal Year
Column 25 Cumulative balance	Historical subtotal
\$ 732,894,080	2001
732,894,080	2002
732,894,080	2003
732,894,080	2004
732,894,080	2005



Contacting Western

For more information about Western or its programs, call or write the following Western offices (these offices can also be accessed through Western's Web site at www.wapa.gov):

Upper Great Plains Regional Office

P.O. Box 35800
Billings, MT 59107-5800
(406) 247-7405 or 1-800-358-3415

Rocky Mountain Regional Office

P.O. Box 3700
Loveland, CO 80539-3003
(970) 461-7200 or 1-800-472-2306

Desert Southwest Regional Office

P.O. Box 6457
Phoenix, AZ 85005-6457
(602) 352-2525

Sierra Nevada Regional Office

114 Parkshore Drive
Folsom, CA 95630-4710
(916) 353-4416

CRSP Management Center

P.O. Box 11606
Salt Lake City, UT 84147-0606
(801) 524-5493

Power Marketing Liaison Office

U.S. Department of Energy
Room 8G-027, Forrestal Building
1000 Independence Ave., SW
Washington, DC, 20585-0001
(202) 586-5581

For no-cost, energy-related technical assistance within Western's service territory, call 1-800-POWERLN (1-800-769-3756.)

