STANDARD & POOR'S

PUBLIC FINANCE

Energy Northwest, Washington

Credit Profile		
US$532.21 mil proj 1, Columbia Generating Sta, & proj 3 elec rev rfdg bnds ser 2007 A-D due 07/01/2024		
Long Term Rating	AA-/Stable	New

Primary Credit Analysts:
Swami Venkataraman
CFA
San Francisco
(1) 415-371-5071
swami_venkataraman@
standardandpoors.com

Secondary Credit Analysts:
Leo Carrillo
San Francisco
(1) 415-371-5077
leo_carrillo@
standardandpoors.com

RatingsDirect
Publication Date
March 16, 2007

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to Energy Northwest (ENW), Wash.'s upcoming $549.2 million electric revenue refunding bonds series 2007 A, B and C and the Columbia Generating Station electric revenue bonds, series 2007 D. The bonds are being issued in connection with the Bonneville Power Administration's debt optimization program.

The program involves extending the final maturities of outstanding ENW bonds and using the proceeds to retire federal debt at Bonneville. The series 2007D Bonds and a portion of the Columbia 2007B Bonds are being issued to finance a portion of the costs planned to be incurred during fiscal year 2008 for maintenance capital expenditure at the Columbia Generating Station as well as plant license extension application.

The 'AA-' rating on ENW's bonds reflects the following credit strengths:

- The seniority of the ENW debt with respect to more than $6.8 billion of federal debt, which ensures debt service coverage of at least 2.0x for the ENW bonds;
- A reduction in wholesale market exposure due to a balance between load and resources starting in fiscal 2007;
- Improved prospects for secondary revenues given elevated gas prices;
- A simplified rate adjustment mechanism that still provides sufficient rate flexibility at the 'AA-' rating level;
- Strong and efficient operations of the federal hydro power system; and

- A broad service territory and large number of customers that provide for protection from utility-specific credit risks and also some protection from localized economic downtrends.

Weaknesses include:

- A highly visible and politicized rate-making process;
- Exposure to volatility in wholesale power markets with more than $2 billion in net secondary revenues over the fiscal 2006-2009 period; and
- The need to secure sustainable future sources of capital

Debt service on the $6.17 billion of outstanding ENW debt as of March 1, 2007 is legally an operating expense of Bonneville, which results in the debt ranking senior to more than $6.8 billion in outstanding Treasury debt and federal obligations related to Bonneville's hydro system. This advantaged position offers bondholders the assurance of debt service coverage of at least 2.0x in every year as long as sufficient revenues are collected to meet all of Bonneville's debt obligations, including the Treasury debt. Even during the western U.S. power crisis, coverage of these obligations remained consistently above 2.0x.

Bonneville's exposure to the wholesale markets changed in a meaningful way starting in October 2006 with the expiration of the last of the high-priced supply contracts entered into in 2001. The expiration of these contracts, in combination with the loss of the direct service industrial (DSI) load and a settlement with investor-owned utilities that substituted power supply for cash payments, has resulted in Bonneville's load and resources now being roughly in balance at 8,600 average megawatts (aMW) even under critical water conditions. However, Bonneville will continue to be exposed to market price volatility because Bonneville sets its customer rates assuming significant revenues from wholesale sales (over $2 billion in 2006-2009) arising from runoff levels above critical water conditions. The surge in forward power prices generated by high gas prices partly mitigated this risk over the immediate term. As in most of the country, natural gas sets the marginal price of power in the Northwest. The exception is the second quarter when hydro runoff is at its peak. High power prices have resulted in strong wholesale revenues and strong financial performance at Bonneville, with the cash balance as of Sept 30, 2006 being $1.1 billion, compared to $548 million as of Sept. 30, 2005.

For 2007-2009, Bonneville will set rates to achieve a 97.5% probability of paying ENW and treasury debt service under a Monte Carlo simulation involving more than 3,000 combinations of primary variables such as water flows, power prices, and load. It is important to note that the probability of meeting just ENW debt service is higher than 97.5% given the substantial amount of subordinated Treasury debt obligations. Bonneville can also legally reschedule treasury debt payments.

Bonneville's rate setting is subject to a lengthy, typically politically charged process involving a host of interested parties, including direct customers, regional economic bureaucracies, environmental agencies, and various other stakeholders. Under new rates that became effective Oct. 1, 2006, Bonneville has the ability to formulaically adjust rates up to $300 million each year to account for wholesale revenue shortfalls, subject to exceptions for potential fish-related issues. The formulaic nature of the adjustment mitigates the risks of a public process through 2009. Although this is different from three different cost recovery adjustment mechanisms that have existed for the past few years, this mechanism is simpler and essentially preserves similar levels of overall flexibility.

Efficient operations of the federal hydro system and historically reliable operations at the Columbia generating station have given Bonneville the ability to maintain very competitive wholesale rates for its customers, currently 2.7 cents per kilowatt-hour (kWh). Moreover, the system's capacity of about 21,000 MW (in January, a low flow month benchmark) spread over 206 generating units provides for tremendous operational flexibility.

Coverage of ENW debt service was very strong in both 2005 and 2004, respectively measuring 7.22x and 6.95x. These coverage levels may decline, however, as the debt optimization program is completed by 2009 and non-federal debt service rises. Nevertheless, the ratio is expected to stay above 2.0x. Equity as a percentage of total capitalization improved to 21.5% from about 13% two years ago. Uncertainty of wholesale revenues is the single most important source of cash flow volatility and the expected net wholesale revenues exceed $2 billion from 2006 to 2009. As a risk management measure, Bonneville prudently sells some of its output forward when water flows are reasonably certain and prices are attractive. We expect Bonneville to exercise its ability to adjust rates as needed to improve liquidity and maintain the target Treasury payment probability.

Liquidity

Bonneville's liquidity management substantially increases in importance with the implementation of the "direct pay" system and we will closely monitor cash flows and liquidity reserves going forward. The reserve level at the end of fiscal 2006 (Sept. 30, 2005), stood at a comfortable $1.2 billion, more than adequate for the rating. This reserve, coupled with a two-year $250 million Treasury note liquidity facility usually reserved for exceptionally cold weather and emergencies, provides sufficient liquidity for Bonneville's operations. Debt optimization funds from ENW could potentially be used to offset operating costs in an emergency rather than to pre-pay Treasury debt. Finally, Bonneville can also alter its federal debt maturity schedule in the event of a crisis.

Outlook

The stable outlook reflects greater confidence in current wholesale revenue projections in light of sustained high gas prices and our expectation that management would adjust rates as may be required to cover cash flow shortfalls. Downside risk to the rating is closely linked to wholesale power prices and hydro flows in the Northwest. Given the significant exposure to wholesale markets and the current lofty rating level, upside rating potential is limited.

Ratings Detail (As Of 16-Mar-2007)		
Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rev rfdg bnds ser 2007 A-D due 07/01/2024		
Long Term Rating	AA-/Stable	New Rating