BONNEVILLE POWER ADMINISTRATION

2006 ANNUAL REPORT

A PIVOTAL YEAR

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DEAR MR. PRESIDENT

This has been an outstanding year for the Bonneville Power Administration. After several years of sustained effort, we have now recovered from the financial effects of the 2000-2001 West Coast power crisis. This year's return to normal water conditions fueled our hydro generation, which, along with our years-long cost-management efforts, enabled us to rebuild our financial health. We also continued to make substantial investments in the region's transmission, generation, energy efficiency and fish and wildlife restoration.

With our financial strength restored, we are focused on the future. We are working collaboratively with our customers, Northwest states, tribes and interested citizens to provide greater certainty on the role of BPA in the Northwest power system.

I feel great about where we are and the direction we are going.

BPA produced modified net revenues of $445 million in 2006 and reduced its wholesale power rates beginning in 2007.

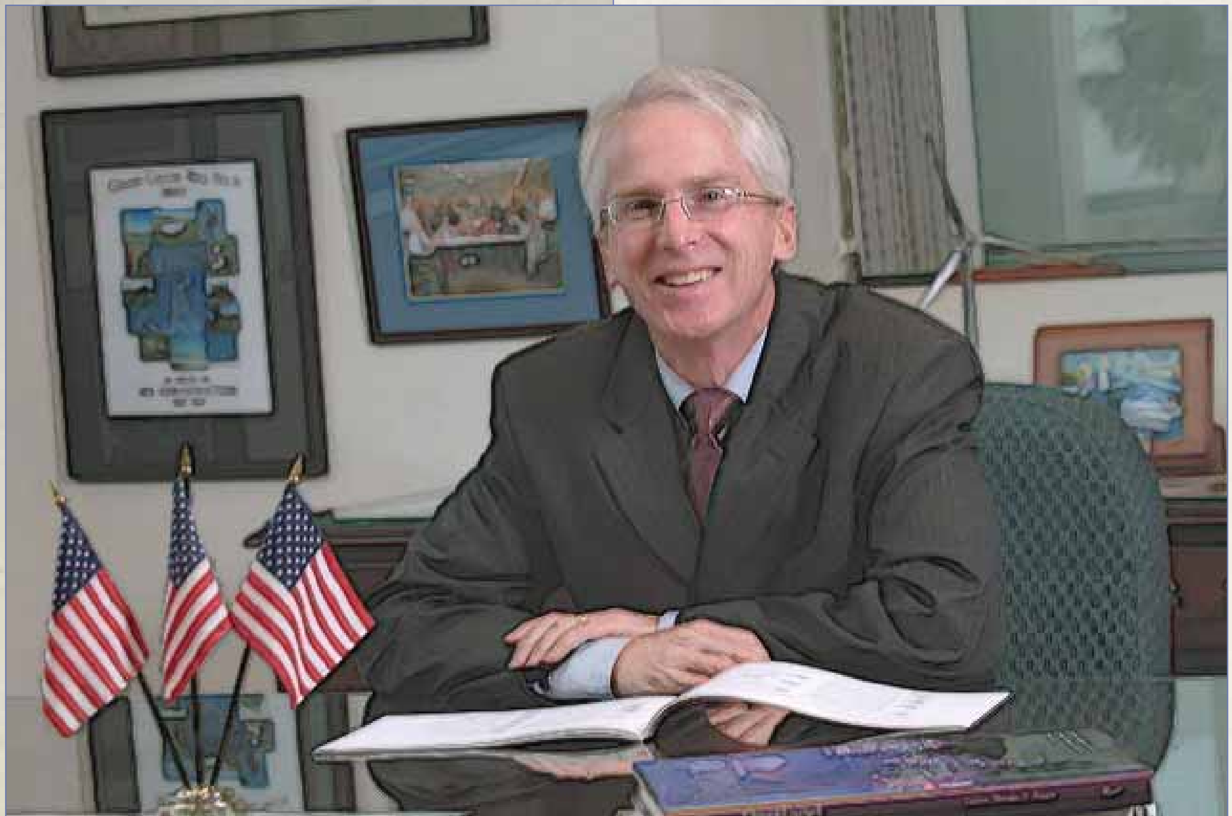
We continued to pay our debt to the Treasury in full and on time and made advance payments of more than $300 million in this year alone through our debt optimization program whereby Energy Northwest refinances bonds due on nuclear facilities. BPA uses the increased cash balances to pay additional Treasury debt, which restores scarce Treasury borrowing authority. We also maintained our high bond ratings. We have continued to control our costs and have reduced staffing. Our 2007-2009 power rates provide the highest probability that we have ever had that BPA will cover all its costs in the next rate period. The probability is 95 percent over two years.

I am immensely proud of the BPA staff and grateful for the regional cooperation that achieved these results.

Weather, as well as hard work, contributed to this year's impressive financial results. For the first time in seven years, the Northwest enjoyed above-average water conditions. That water, together with high market prices, led to BPA's highest ever revenue for surplus power sales.

> "With our financial strength restored, we are focused on the future."

BPA was well positioned to take advantage of this good fortune. After years of difficult cost-management decisions and after making a new arrangement for directly paying Energy Northwest costs, we ended the year with $1.193 billion in financial reserves, our highest ever, after making our Treasury payment. This helped us



lower power rates. About $250 million of the reserves are a cash flow shift resulting from the direct pay arrangement with Energy Northwest. Through collaboration with customers, we developed a liquidity tool that was the key final ingredient that allowed us to lower our 2007 power rates.

Looking to the future, this year we issued our proposal for long-term wholesale power contracts that will replace the existing contracts that expire in 2011. This will give Northwest parties the certainty they need about their responsibilities for meeting load growth after 2011. Their long-run assurance is the key to development of electric infrastructure that will be crucial to the ongoing health of the Northwest economy. The aptly named Regional Dialogue proposal, which grew out of four years of public involvement regarding long-term contracts, promotes utility and private-sector development of electric energy infrastructure. It will significantly reduce risk and further ensure that BPA will continue to fully repay taxpayers' investment in the Columbia River power system. I look forward to signing the record of decision on this historic policy in 2007.

We moved forward this year to improve reliability. We launched a regional congestion management group to help us develop new and better tools to manage transmission congestion. This effort resulted in a proposal that BPA will implement in 2007. Also, we are working as a partner with other utilities to establish a regional transmission organization, ColumbiaGrid.

We supported renewable resources, providing new transmission facilities for the third consecutive year to integrate wind power. This has now nearly doubled the amount of wind power integrated into the BPA grid. BPA and the Northwest Power and Conservation Council have launched a regional wind integration action committee to assess how to cost-effectively integrate the substantial amounts of wind being planned and developed in the Pacific Northwest.

This year also produced good news about Columbia River salmon runs. Two decades of investments in hydro system improvements for salmon are paying off. The last five years have seen the highest salmon returns in the last 60 years. Juvenile salmon survival through the hydro system is higher today than it was in the 1960s, before four of the eight lower Columbia and Snake river dams were built. BPA is working with federal, state and tribal sovereigns to produce a long-term plan that will meet our mitigation and recovery goals.

In 2004, BPA re-specified its vision and established a new strategic direction based on four pillars: high reliability, low rates, environmental stewardship and regional accountability. We have been revising our internal operations to pursue this vision ever since, subjecting virtually all parts of BPA to bottom-up efficiency reviews. The process improvements we've found so far are expected to reduce spending by tens of millions of dollars annually when fully implemented.

This year, we reorganized the agency to assure that we will realize these savings. Our new structure will reduce redundancies and strengthen our ability to deliver our mission.

We also formally adopted core agency values. They are:

- *Trustworthy stewardship.*
- *Collaborative relationships.*
- *Operational excellence.*

These values reflect what I see exhibited every day at BPA. Striving always to fulfill these values, we are reaffirming our status as a utility focused on serving the public interest and as an industry leader performing highly effectively and efficiently.

BPA has turned itself around financially in the last four years while lowering rates. This provides a solid foundation to continue our efforts to support adequate regional infrastructure investment and responsible environmental stewardship. We are now aggressively striving to meet our next challenges in serving the people of the Pacific Northwest.

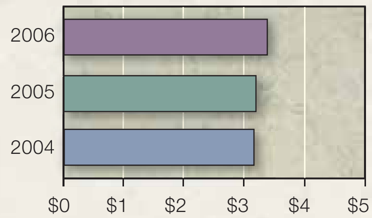
Stephen J. Wright

Stephen J. Wright
Administrator and CEO

FINANCIAL RESULTS

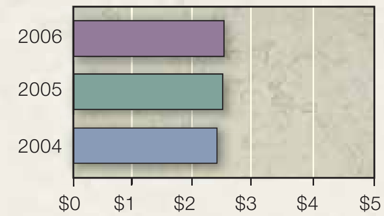
Operating Revenues

billions of dollars



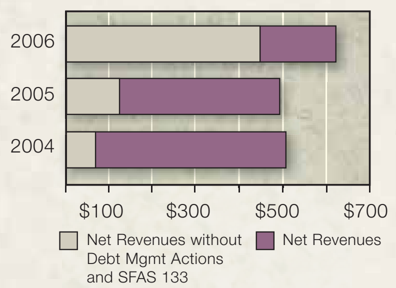
Operating Expenses

billions of dollars



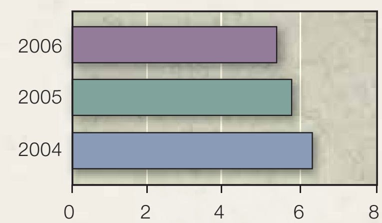
Net Revenues With and Without Debt Management Actions and SFAS 133

millions of dollars



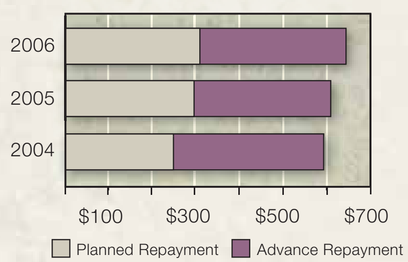
Nonfederal Debt Service Coverage Ratio

times covered



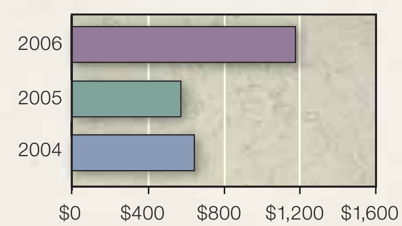
Status of Treasury Principal Repayment

millions of dollars



Financial Reserves

millions of dollars



These charts depict important BPA and Federal Columbia River Power System financial measures. *Net Revenues With and Without Debt Management Actions and Statement of Financial Accounting Standard 133* reflect the impact of nonfederal debt management actions and SFAS 133 (see SFAS 133 and Related Guidance in the first note to the Financial Statements). *Nonfederal Debt Service Coverage Ratio* demonstrates how many times total nonfederal project debt service is covered by net funds available. A ratio of 1.0 is the minimum required to show adequate funds to meet debt service payments to nonfederal bondholders. The *Status of Treasury Principal Repayment* shows the planned and advance payment of federal appropriations and U.S. Treasury bonds. *Financial Reserves* is the sum of BPA cash and deferred borrowing authority at year end.

A PIVOTAL YEAR

Fiscal year 2006 completed a dramatic turnaround for the Bonneville Power Administration. We achieved record revenues, and can now say with confidence that BPA has recovered financially from the West Coast power crisis of 2000-2001.

Revenue record set

BPA produced net revenues of $611 million, $230 million above start-of-year projections. Absent effects of debt management actions and Statement of Financial Accounting Standard 133, we produced modified net revenues of $445 million. After losing more than $700 million during the West Coast power crisis, and enduring six consecutive years of below average water, BPA has largely made it back from those losses.

Above-average water conditions, the first in seven years, share some of the credit for these results. Coupled with strong market prices, the water produced record net secondary revenues that exceeded the previous record by over $200 million. This helped offset record losses during the 2001 drought and West Coast power crisis.

Continued cost control and conservative financial management also contributed to the agency's strong financial performance. Internal operating costs of $492 million were $33 million below the annual budget amount of $525 million. Since 2002, BPA's federal and contractor staff have declined by 10 percent.

Debt managed

BPA made its annual debt payment of $1.113 billion to the U.S. Treasury in full and on time for the 23rd year in a row. This includes $337 million in advance repayments to Treasury.

Prepayment of Treasury debt is part of our ongoing debt optimization program. BPA and Energy Northwest refinanced $842 million in Energy Northwest bonds this year, saving ratepayers about $53 million in the next rate period. All three major bond rating agencies affirmed their existing high bond rating for these transactions. For only the second time since 1989, an entire bond sale was completed without bond insurance, reducing the cost of issuance and demonstrating the market's confidence in our financial health.

Rates reduced

During fiscal year 2006, we set power rates for fiscal years 2007-2009 and reduced

our base average wholesale power rate 3 percent for fiscal year 2007. Our average base rate for priority firm power in 2007-2009 is $27.33 per megawatt-hour.

The 2007-2009 power rates are adjustable to assure Treasury payment and funding for fish recovery actions related to ongoing court proceedings. The Treasury payment probability incorporated in these rates meets our own target of 95 percent probability over two years or 92.6 percent over three years. This is the highest probability BPA has ever achieved in a power rate case.

The hallmark of our recent power rate case was customer cooperation and collaboration. Customers recommended and 33 signed up for a flexible power rate program that will enable BPA to increase cash flows on short notice if needed. This reduced the need to carry financial reserves, which lowered our effective base power rates for 2007-2009.

Our customers also worked collaboratively to put in place an agreement for BPA to directly pay Energy Northwest nuclear project costs rather than paying these costs through our customers. This smooths BPA's annual cash flow, allowing BPA to lower average rates 5 percent compared to what they would otherwise have been.

Customer collaboration in the 2007 power rate case demonstrates that, when we work together, good things happen for the Pacific Northwest.

Costs controlled for next rate period

Lower power rates for fiscal year 2007 also reflect results of an 18-month Power Function Review of BPA's power cost structure, conducted with customers and stakeholders, which reduced planned spending by $122 million a year over the rate period.

On the transmission side, BPA invited utility customers, stakeholders and ratepayers to review BPA's plans for transmission system investment and operating costs in fiscal years 2008-2009. The Programs in Review public process is expected to be completed this fall. The results will be reflected in the transmission rate case for that period to be held in 2007.

Fish cost recovery better assured

Currently, about one-third of BPA's priority firm power rate represents costs of its fish and wildlife mitigation and recovery program, including lost revenues and power purchases to support required spill and other hydro operations related to the Endangered Species Act.

BPA's fiscal year 2007-2009 power rates include two mechanisms designed to specifically recover costs of any additional fish recovery actions taken to resolve existing lawsuits on salmon recovery. For the period after 2011, BPA's Regional Dialogue proposal would significantly enhance the stability of funding for fish recovery requirements.

> "When we work together, good things happen for the Pacific Northwest."

DSI benefits extended

BPA signed contracts in 2006 with remaining direct-service industries for services and benefits for fiscal years 2007 through 2011. Port Townsend Paper Co. will receive 17 average megawatts of power. The three remaining Northwest aluminum companies will receive monetary benefits of up to $59 million a year to support their market purchase of up to 560 average megawatts of power. The policy gives the companies and their employees a chance to continue operations and retain jobs without unduly burdening other regional consumers.

The question of whether to continue support to the DSIs after 2011 poses many difficult policy issues. To help ensure we make the right policy choice, BPA commissioned an independent study of potential costs and benefits to the region of continuing service to the DSIs beyond 2011. The study and public comment will inform BPA's final decision on the issue in 2007.

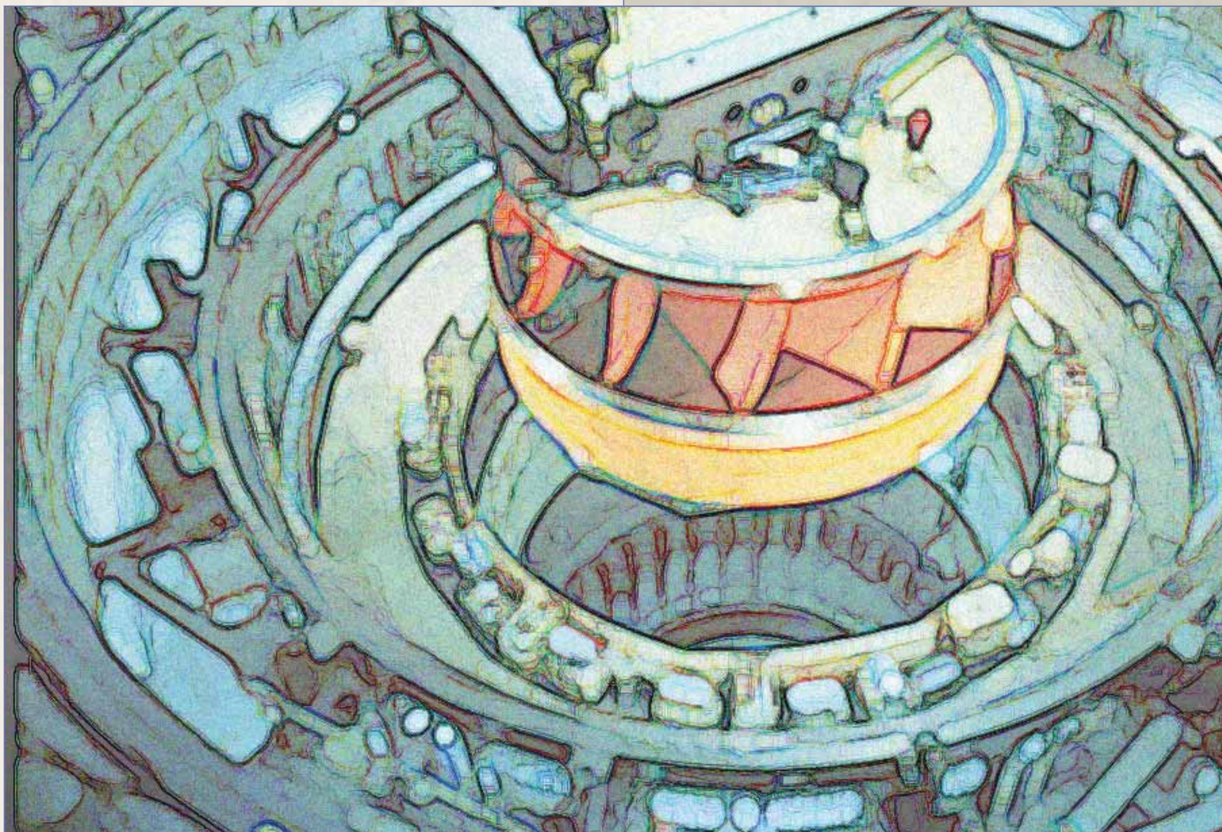
> "The region took major steps this year to guide individual utilities in their resource planning efforts."

Long-term power supply role proposed

With BPA's current costs under control and financial health restored, the region has been able this year to focus on BPA's future. We released our Regional Dialogue proposal for our long-term role in the Northwest power supply. This proposal reflects years of collaborative discussions among regional parties. It will give Northwest utilities, BPA and resource developers the certainty and accurate price signals they need to develop new power resources to meet future Northwest needs.

BPA's publicly owned utility customers will receive more certainty about "Tier 1," the amount of federal power they would receive at BPA's lowest cost-based rate after 2011, when current power sales contracts expire. Power sold under the Tier 1 rate would roughly equal the output of the existing Federal Columbia River Power System. For power needs beyond this amount, utilities could develop their own resources, purchase in the market or buy additional firm power from BPA at a Tier 2 rate based on BPA's cost of new resources or market purchases.

This approach will be further explored during 2007 as BPA works toward offering new 20-year power sales contracts in 2008. The contracts would give customers certainty about their power supply from BPA and would give BPA greater assurance of revenues to meet its financial obligations, including timely BPA debt repayment to the U.S. Treasury. In turn, a detailed regional cost review process would continue BPA's



cost transparency and customer and stakeholder input into BPA cost decisions.

The proposed approach also is designed to settle long-standing issues among BPA customer groups. Investor-owned and publicly owned utilities would settle their residential exchange benefits for the term of 20-year power sales contracts. BPA customers would choose from products much like those available today, which would detail their business relationship with BPA for the term of their 20-year contracts. These features depend on a sufficient level of regional agreement to implement them successfully. Absent sufficient agreement, BPA will drop features that require consensus and implement terms that remain.

We intend to complete the Regional Dialogue policy in 2007 and sign contracts in 2008. This timeline and the certainty provided by the Regional Dialogue construct will give BPA customer utilities sufficient lead time to secure additional resources they need for 2012 and beyond.

Resource adequacy addressed by the region

The region took major steps this year to guide individual utilities in their resource planning efforts. BPA and the Northwest Power and Conservation Council convened a Pacific Northwest Resource Adequacy

Forum. The group produced a Northwest Resource Adequacy Standard that includes a metric — a yardstick for measuring regional energy supplies — and a target that defines adequacy. The regional forum defined a capacity standard, resource counting and data reporting protocols and an implementation mechanism. These actions represent major milestones in the effort to assure there is no second West Coast power crisis, which was due in part to inadequate resource supplies.

Conservation achieved

BPA and its customer utilities have added more than 1,000 megawatts of energy efficiency to the region's power supply since passage of the Northwest Power Act, as much as a large nuclear plant. BPA met its 2006 energy efficiency targets, delivering 44 average megawatts of new conservation from its energy efficiency programs at a cost of less than $1.5 million per average megawatt. As a participant in Department of Energy's National Action Plan for Energy Efficiency, BPA is increasing its annual conservation target from 40 aMW to 52 aMW per year. The American Council for an Energy Efficient Economy recognized BPA this year as a national Champion of Energy Efficiency.

BPA's customer-driven conservation and renewable resource programs encourage local initiative. For example, the city of

Ellensburg, Wash., launched a 24-kilowatt city solar energy plant funded by a BPA rate credit and a grant from the Bonneville Environmental Foundation. Local residents pledged $80,000 to buy shares in the project in return for credits on their electric bills.

We are particularly proud of our collaborative energy efficiency projects with federal agency customers. McChord Air Force Base in Washington state has completed $1.5 million in lighting retrofitting, the first stage in BPA's multi-year, $6 million conservation program at the base. The Air Force reimburses costs of this program. BPA has $23 million in engineering and construction projects under contract in a partnership with the U.S. Navy at two large bases BPA serves directly. The Navy fully reimburses costs of these projects. BPA is also providing $3 million in conservation incentives for Navy projects.

Fish, power, flood control needs met

After six years of below-average water, this year's water, which was slightly above average, appeared bountiful. Columbia River runoff at The Dalles for January-July 2006 was 114.7 million acre feet, or 107 percent of the 1971-2000 average.

The return to better water brought renewed challenges in juggling the multiple uses of the Columbia River. Strong spring flows in the Kootenai River below Libby Dam briefly flooded parts of Bonners Ferry, Idaho, while high water releases at Libby Dam created nitrogen saturation in the Kootenai at levels dangerous to endangered white sturgeon and bull trout. At the same time, Lake Koocanusa behind the dam briefly inched over reservoir level limits set under the Columbia River Treaty with Canada.

> "Two decades of investments in hydro system improvements for salmon are paying off."

Ample spring runoff fueled BPA's high surplus power sales.

As a record-setting July heat wave approached the West, BPA set up its power system with an eye toward being able to lend support to neighboring control areas if needed. BPA topped off reservoirs, fully charged the pumped storage capacity at Banks Lake, Wash., and deferred maintenance on critical transmission and generation resources.

BPA's actions paid off in maintaining system reliability. We responded to calls for emergency power from four Northwest utilities and California. Transmission lines between the Northwest and California operated by BPA delivered up to 6,700 megawatts of power to California. The head of the California Independent System Operator later wrote BPA, saying California avoided rolling blackouts "thanks to your support and collaboration."

"In the first quarter of 2006, we energized our third new 500-kilovolt project in as many years."

All fish spill requirements were fully met during the record heat wave and throughout the year. As in 2005, under court direction, federal operators spilled water for juvenile fish migration through the end of August. A report on the 2005 summer spill identified cost of summer spill that year as $76.6 million.

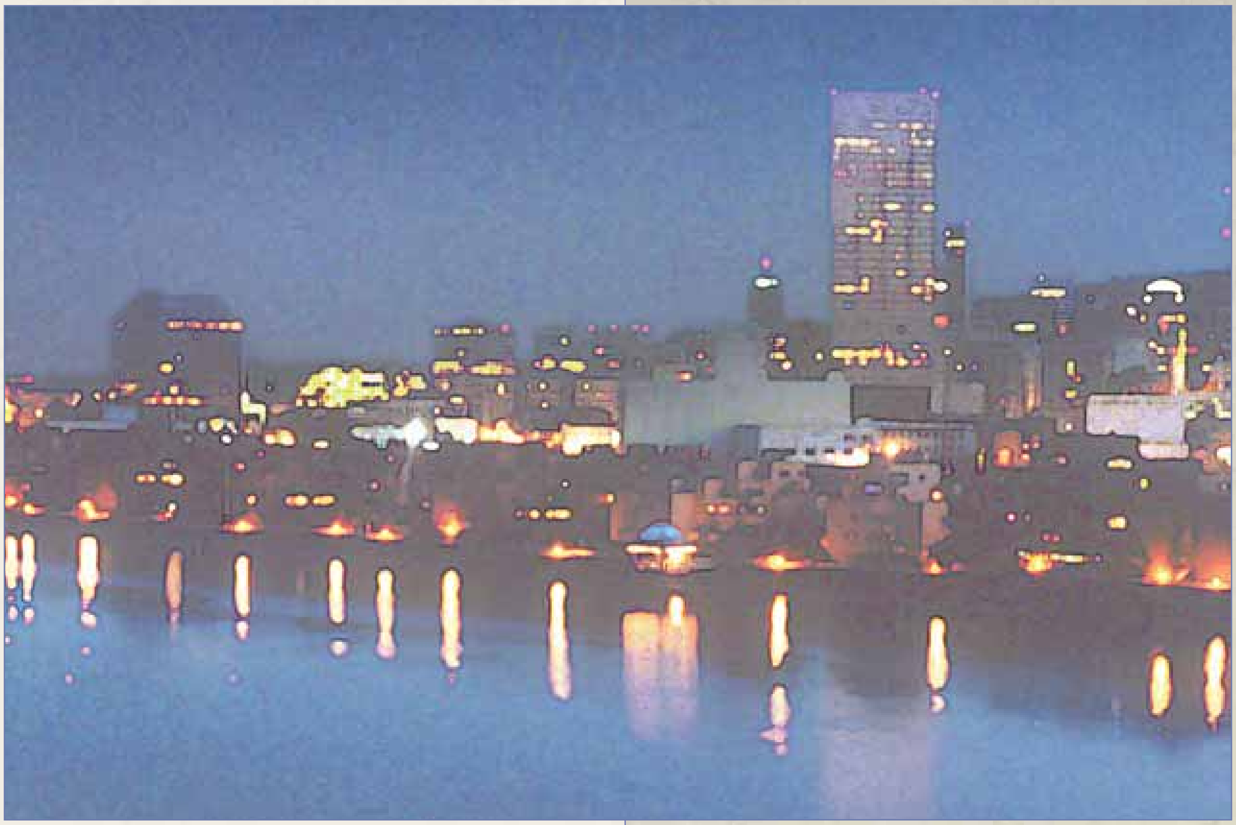
Nuclear performance record set

As the fiscal year closed, Energy Northwest's Columbia Generating Station nuclear plant turned out a record 454th day of continual operation — and kept on running. The plant has operated at or near full power since July 2, 2005, with occasional downpowers for maintenance or load shaping. Load shaping occurs when BPA requests lower production due to a seasonal surplus of hydropower. BPA receives all the output of this plant. Columbia Generating Station moved from annual refueling to a two-year refueling cycle in 2001. It will next refuel in spring 2007.

Reliability maintained

Federal power generation and BPA's transmission grid met all reliability and availability targets this year. Hydro generating units met their target of 97 percent heavy load hour availability. BPA's most important transmission lines were available for service 98.8 percent of the time.

It has become increasingly difficult to maintain the transmission system so it can provide the services demanded of it.



For example, BPA has a backlog of more than 10 years for replacing aged and worn spacer dampers. These replacements are needed to keep transmission conductors safely spaced. It is becoming more difficult to find outage time to do this work when it will not affect market conditions. Planned outage time for our most important lines has grown by about 14 percent a year over the last three years.

Nonetheless, BPA complied fully with Western Electricity Coordinating Council Reliability Management System Standards. This was challenging, as the transmission grid faces growing congestion and use. Managing competing priorities, BPA sometimes operates near the edge of system capacity to maximize availability while maintaining safe, reliable transmission system operation.

Infrastructure augmented

To maintain reliability, BPA has invested more than $1.2 billion in recent years in transmission system projects, including construction of new high voltage lines, rebuilding existing lines and substation upgrades.

In the first quarter of 2006, we energized our third new 500-kilovolt project in as many years. The 63-mile, $164.2-million Schultz-Wautoma line adds 600 megawatts of transfer capacity to the heart of BPA's

transmission grid in central Washington. The line came in on time and well under budget.

We also enhanced reliability in the busy I-5 corridor, reconductoring two lines north of Seattle and upgrading the key Ostrander-Pearl 500-kV line in the Portland area.

In all, BPA conducted 14 significant transmission infrastructure projects in 2006.

Wind power supported

The Northwest is now one of the fastest growing areas of the country for wind power development.

BPA energized two new substations this year to integrate new wind power projects, bringing to nine the number of transmission construction projects BPA has completed since 1998 for integration of wind farms. For example, BPA's new Jones Canyon Substation near Arlington, Ore., delivers more than 100 megawatts of wind power from the Leaning Juniper Wind Farm directly into BPA's 230-kV main grid.

The region now has more than 1,300 megawatts of wind energy installed with another 1,000 megawatts or more expected in the next few years. BPA and the Northwest Power and Conservation Council have launched an effort to develop a Northwest Wind Integration Action Plan to determine how the region can best manage the variable nature of wind power so its advantages can be fully realized. A draft action plan is expected in January 2007.

Non-wires demonstration launched

BPA continues to seek ways to deliver power to its customers with the lowest environmental and economic impact. This can postpone the need for new transmission construction through non-wires alternatives. In January, BPA joined with the Pacific Northwest National Laboratory and other sponsors in launching a U.S. Department of Energy GridWise demonstration project on the Olympic Peninsula in Washington state.

In this pilot, Internet technology is used to send signals to control electric space and water heating loads in the homes of 300 participating volunteers. The goal is to see if appliances automatically responding to price signals can reduce peak power loads and thereby delay the need for new transmission lines. Several homes in this demonstration project also have clothes dryers equipped with a special chip that senses frequency changes on the transmission grid. When the frequency drops below an acceptable level and the dryer is running, the chip turns off the heating element of the dryer for a few minutes until grid frequency stabilizes.

> “BPA continues to seek ways to deliver power to its customers with the lowest environmental and economic impact.”

Transmission congestion addressed

The number of transactions over BPA’s transmission grid is increasing, and operating it is becoming more complicated. BPA handled almost 55,000 transmission transactions in June 2006, versus 30,000 in that month four years ago. This represents a growth rate of about 16 percent a year for the last four years. To measure the impacts of this added volume on operators, we developed a complexity index. It measures a combination of factors such as tagging transaction volume, planned outage minutes, total transmission system load and significant outages to schedule. The result suggests the complexity of operating BPA's transmission system or system stress has been growing by about 13 percent a year over the past three years.

Transmission congestion issues were outlined in greater detail this year in a BPA white paper, "Challenge for the Northwest: Protecting and managing an increasingly congested transmission system." BPA convened a regional steering committee in the spring to develop mechanisms to alleviate the problem. The committee adopted a variety of tools in late August which included three components:

- limiting nonfirm schedules on congested paths,
- a within-hour redispatch tool, and
- an interim tool that limits the scheduling of nonfirm for the hour after flows exceed safe limits on transmission paths.

BPA intends to begin implementing the plan on its system beginning in summer 2007.

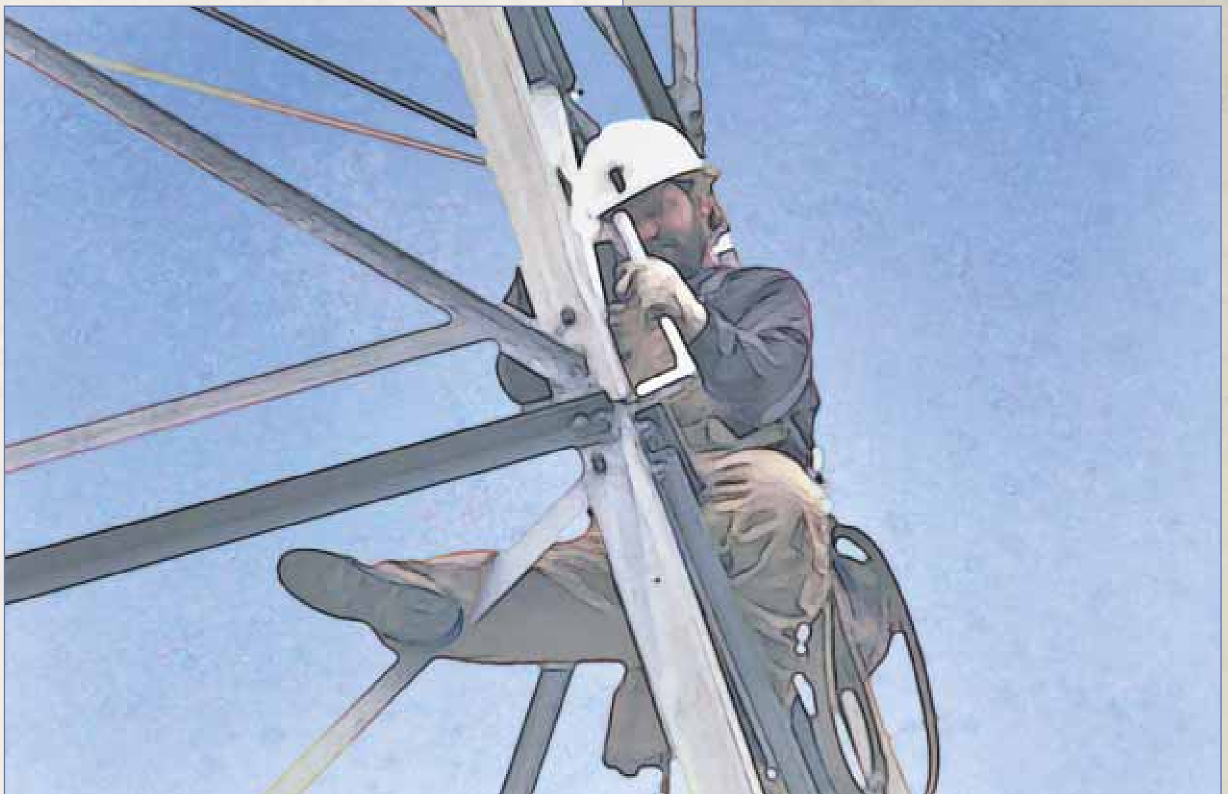
> "BPA believes the optimal solution to stress on the grid is one-utility transmission planning and operation for the Pacific Northwest."

National efforts supported

BPA is actively participating in national efforts to improve management of the nation's high-voltage transmission grid. For example, BPA is assisting the Western Electricity Coordinating Council efforts to register all Northwest utilities appropriately in response to registration requirements of the North American Electric Reliability Council as the nation's new Electric Reliability Organization. BPA is working with its customers to develop a comprehensive, consistent approach to registration for BPA and the entities in its control area.

ColumbiaGrid emerges

BPA believes the optimal solution to stress on the grid is one-utility transmission planning and operation for the Pacific Northwest. We have worked with regional

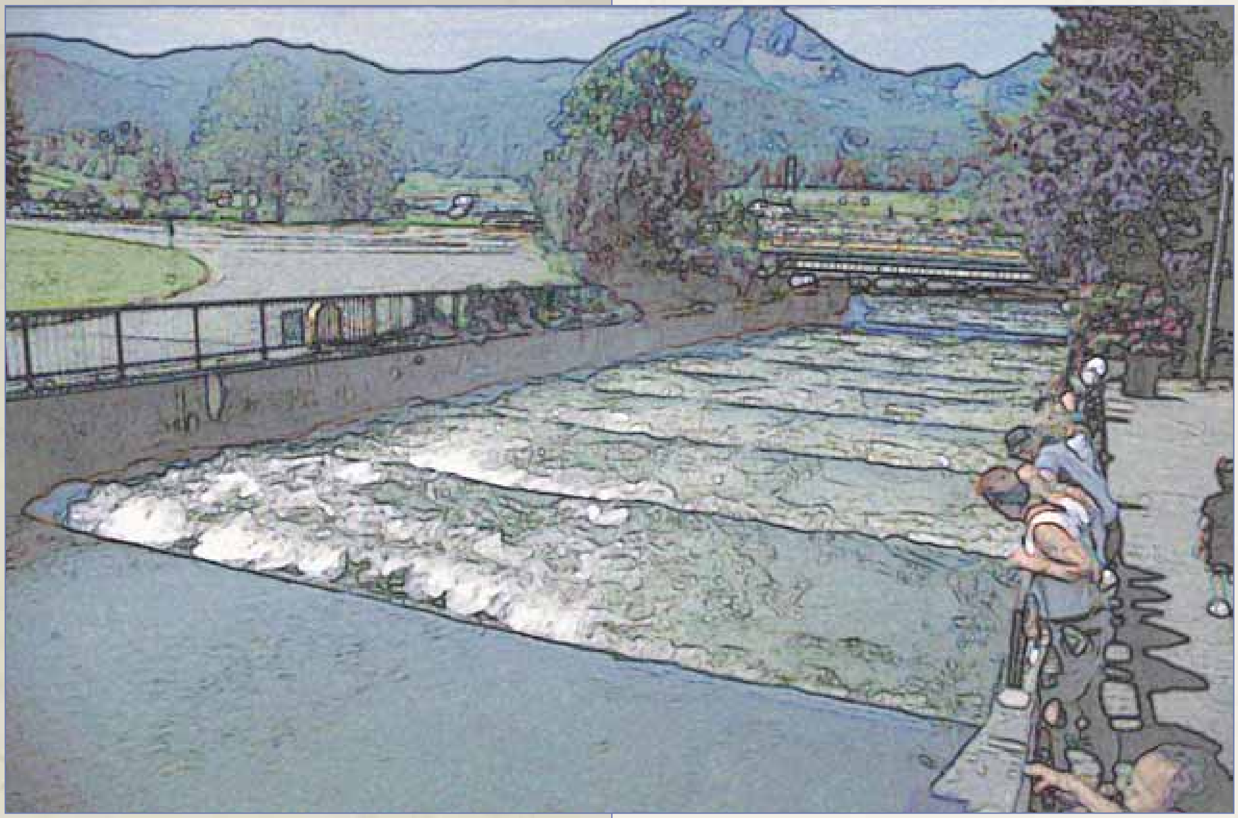


parties for years to realize this goal. This year, BPA became a founding member of ColumbiaGrid, along with investor-owned utilities Puget Power and Avista, the public utility districts Grant and Chelan counties in Washington and Seattle and Tacoma municipal utilities. Other Northwest control areas are invited to join.

ColumbiaGrid is an independent entity that will integrate the operation and expansion of the region's transmission network. It will take on some planning and reliability functions both for members and for those parties who have signed functional agreements with ColumbiaGrid. BPA is providing $2.4 million of the initial two-year, $5 million startup funding agreement. ColumbiaGrid has incorporated as a non-profit corporation in the state of Washington. A three-member independent board has been seated. The entity is working toward providing initial services before the end of calendar year 2006.

Yakama Power becomes BPA customer

A new BPA customer, Yakama Power, began receiving BPA preference power in April with an initial load of about 3.25 megawatts. The Yakama Indian Nation became interested in setting up its own utility eight



years ago, when BPA defined tribes as public bodies eligible to buy electricity directly from BPA. Yakama is serving residential, government, commercial and industrial load previously served by PacifiCorp. The utility has already begun work on a residential conservation program and is implementing BPA's Low Income Weatherization Program. BPA also serves other tribal utilities.

Fish survival increases

The outlook is improving for Columbia River salmon. The highest Columbia River salmon runs in the last 60 years have been those of the last five years. With good returns of summer chinook, commercial fisheries on these stocks have been allowed in the river each year since 2003 — after being closed continuously since 1965.

While some of this good news is due to improved ocean conditions, improvement in the swift and safe passage of juvenile salmon through the dams is helping. In-river survival of Snake River juvenile salmon today is comparable to that of the 1960s, when there were four dams on the lower Columbia and Snake river system instead of today's eight.

BPA investments to improve fish passage through the hydro system are paying off. Dams on the lower Columbia and lower Snake have extensive fish passage facilities.

Average survival past the dams for young fish today is more than 95 percent per dam. Removable spillway weirs at Lower Granite and Ice Harbor dams safely and efficiently pass juvenile fish with a 97 to 99 percent survival rate. Of fish transported downstream, 98 percent survive to release in the estuary. Efforts to control pikeminnow and Caspian tern predation are effective and save millions of juvenile out-migrants each year.

About 98 percent of returning adult fish survive Columbia and Snake river fish ladders. However, sea lions preying on salmon below Bonneville Dam remain a concern, consuming an estimated 2.8 percent of the run this year. The U.S. Army Corps of Engineers has installed exclusion devices to keep them out of the fish ladders.

Sovereign collaboration progresses

Under the direction of U.S. District Court Judge James Redden, BPA, the U.S. Army Corps of Engineers, Bureau of Reclamation and NOAA Fisheries are working with the four Northwest states and seven Columbia Basin tribes to develop scientifically based goals and performance standards for juvenile and adult salmon and steelhead survival and a 10-year suite of actions for hydro operations, habitat, harvest and hatcheries. NOAA expects to produce a final Biological Opinion by February 2007.

In a separate action, Judge Redden ruled that biological opinions for the Upper Snake River and the Federal Columbia River Power System should be done together to assure a comprehensive analysis. This may delay completion of the FCRPS Biological Opinion.

> "The highest Columbia River salmon runs in the last 60 years have been those of the last five years."

Kootenai white sturgeon plan implemented

BPA and the Corps completed a court-ordered consultation with the U.S. Fish and Wildlife Service to address continued decline of Kootenai River white sturgeon. The stock has dwindled to an estimated 500 adults and is declining at a rate of 9 percent a year. To prevent extinction, BPA and the Corps are providing flow from Libby Dam, regulating the elevation of Kootenay Lake and modifying habitat to improve conditions for spawning. BPA also funds a conservation aquaculture program run by the Kootenai Tribe of Idaho.

> "Habitat improvement projects this year gave fish access to more than 200 miles of previously blocked streams."

Habitat improved

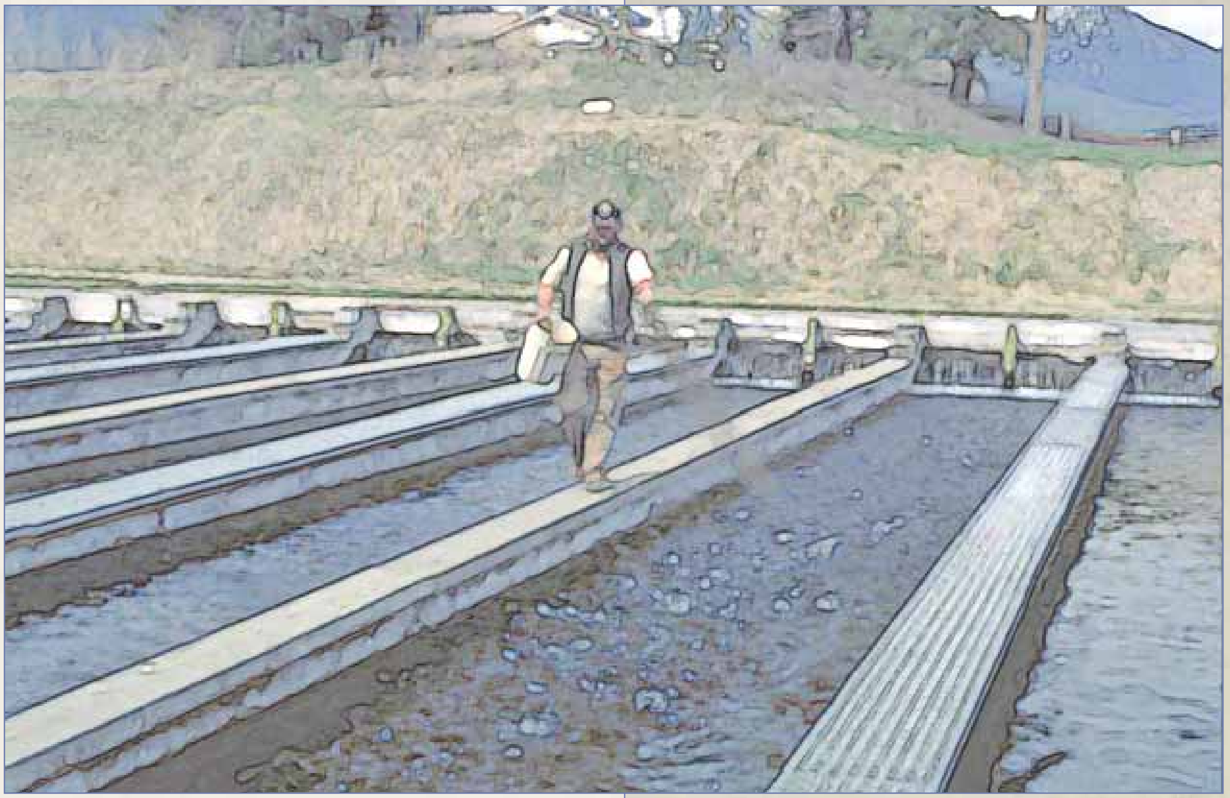
BPA habitat improvement projects this fiscal year gave fish access to more than 200 miles of previously blocked streams and protected and enhanced more than 1,550 miles of salmon habitat on tributaries. In the last six years, more than 1,480 miles of salmon habitat have been opened and more than 2,550 miles of habitat secured and protected. BPA spends more than $35 million a year for fish and wildlife habitat improvements in the Columbia River Basin and estuary.

Hatcheries and harvest addressed by region

Regional collaboration this year also extended to harvest and hatcheries. BPA supports hatchery reform for best management practices and research on selective harvest practices and techniques that target healthy runs, such as terminal fisheries. BPA is participating in a NOAA-led collaborative regional strategy leading to hatchery reform throughout the Northwest. Completion is due in 2008.

Efficiency enhanced

We are reorganizing BPA to better deliver on our mission. This is the third step in a sequence of actions we're taking to optimize the total value of the Federal Columbia River Power System to stakeholders. Two years ago, we renewed our mission and vision and set a new strategic direction. Last year, we launched the first projects in our Enterprise Process Improvement Program,



which aims to streamline virtually all our internal systems and processes. So far, EPIP reviews anticipate tens of millions in annual savings upon full implementation of the recommended changes.

Our reorganization is consolidating support functions that had been dispersed throughout the agency, eliminating redundancies, reducing overhead and enhancing management controls. The reorganization adheres to standards of conduct set by the Federal Energy Regulatory Commission to assure open and nondiscriminatory transmission access. The reorganization was effective Oct. 1, 2006.

Operational excellence is the driver behind our efficiencies projects, our reorganization and cultural changes. These changes collectively represent a new way of operating that better supports our mission and vision to be an industry leader — an organization that others benchmark against.

Risks treated

BPA actively manages its transacting, credit and enterprise risks through a rigorous risk management program. This year, we implemented credit policies designed to ensure that trading strategies, their constituent power transactions and associated risk

exposure limits are appropriate given BPA's risk tolerance and objectives.

We are applying risk management discipline throughout the agency. For example, thorough risk assessment resulted in a proposal to rebuild BPA's 55-year-old Libby-Troy line in Montana at its existing 115-kilovolts, rather than increasing it to 230-kV or going to double-circuit. This proposal would save $13 million while maintaining long-term reliability.

California issues resolved

BPA and Southern California Edison have agreed to settle two lawsuits filed by SCE against BPA in the U.S. Court of Federal Claims regarding a 1988 power sales and exchange contract. The two claims total $208 million. BPA will pay SCE $28.5 million plus interest, but not until the California Public Utility Commission approves SCE's participation in the agreement and there is resolution of the pending California Refund Process with respect to the net amounts owed to or by BPA. The settlement resolves longstanding and potentially expensive litigation at a modest cost. The cost may be offset by payments BPA believes it is owed by a variety of California parties in the ongoing California Refund Process, which stems from the West Coast power crisis.

Slice issues settled

After nearly two years of mediation, BPA and its publicly owned utility customers came to agreement on issues associated with our Slice power product. The settlement allows BPA's public agency customers to resolve issues that amount to hundreds of millions of dollars and removes customer concerns that Slice runs unacceptable risks of cost shifts.

The Slice product is designed to give the purchaser a percentage of FCRPS output in return for paying the costs of that output. Introduced in 2002, Slice is very complex. Aspects of the Slice contract and rate were interpreted differently by the parties and have been subject to litigation before the Ninth Circuit Court of Appeals. The settlement agreement establishes precedents limiting the scope of future disputes and lays out protocols for communication and dispute resolution in the future.

Transparency increased

BPA conducted a Capital Planning Review this year with customers and interested parties to build understanding about how BPA plans for the long term and ultimately makes decisions on agencywide capital planning. The Capital Planning Review examined capital proposals and projects likely to affect post-2009 rates.

By 2008, BPA intends to align its transmission and power rate cases and consolidate its public processes on agencywide expenses and capital plans, so that customers and constituents fully understand and have enhanced opportunities to comment on how ratepayer dollars are spent.

> "We are reorganizing BPA to better deliver on our mission."

Security enhanced

As a key part of the Northwest's infrastructure, BPA is highly aware of the need for security and emergency preparedness. This need was brought home in January when 11 individuals were indicted on charges of attacks on infrastructure that span several years and five states and caused an estimated $100 million in damages. Three of the defendants were charged with the destruction of a BPA high-voltage tower in Bend, Ore., on Dec. 30, 1999.

BPA continues to invest in security enhancement with risk assessments of our most critical facilities. Enhancements this year include electronic monitoring systems, cardkey access, improved fencing and expanded cooperation and planning with regional law enforcement.

Safety maintained

One crucial target we met this year is safety. Our lost time accident rate of 1.2 per 200,000 hours worked is on the very low end of the target range, and is considerably below the industry average. BPA consistently performs better than utility industry safety benchmarks. We adopted Occupational Safety and Health Administration private sector standards more than 20 years before they were required. Our safety motto is heartfelt: No job is so important and no service so urgent that we cannot take the time to perform our work safely.

> "No job is so important and no service so urgent that we cannot take the time to perform our work safely."

Performance measures up

BPA met all of its targets this year for reliability, budgets and schedules for infrastructure investment, establishment of financial management controls and implementation of the President's Management Agenda. All our managers work toward specific targets set in performance contracts each year.

The best measurement of our performance is the response from our partners in the region — our customers and constituents. We measure our performance each year through customer, constituent and tribal satisfaction surveys. This year, we are delighted to report, satisfaction with our performance is noticeably up across the board.

Customers rated their overall satisfaction with BPA at 7.8 out of a possible 10. That's a significant improvement over last year's 7.3 rating, which exceeds our target range of 7.0 to 7.5.

Similarly, constituent ratings rose to 7.7, exceeding the target range of 7.0 to 7.5. The constituent rating was 7.4 in 2005. We use the term constituents to encompass those non-utility interests who regularly track BPA issues, such as the Northwest congressional delegation offices, Northwest governors' offices, state energy offices and public utility commissions, and public interest groups.

Performance scores for tribal government satisfaction also improved with tribal satisfaction going to 6.6 up from 6.4 in 2005. Tribes generally felt they had good working relationships with BPA. However, they indicated a need for more direct dialogue with BPA senior management.

Employees honored

We are honored that, this year, the Department of Energy renamed its Professional Aviation Operation/Support award in memory of BPA helicopter pilot John Cooley, who was killed in 2004 when his helicopter crashed as he was stringing conductor for a new BPA transmission line. John Cooley's wife Mary Ann, 13 family members and friends, and BPA's senior vice president for Transmission, were present for the 2006 award ceremony.

We are also proud of our employees' record in community service. For the third consecutive year, BPA received the Secretary

of Energy's Community Service Award. The award recognizes the more than 16,000 hours that BPA employees contributed to community programs last year, from the BPA Science Bowl to construction of a traditional tribal cedar plank house on the Ridgefield National Wildlife Refuge in Washington.

Prepared for challenges ahead

BPA employees have brought about the agency's financial recovery with energy and creativity, in collaboration with one another and with the region we serve.

As we establish new, streamlined procedures, we are documenting and training staff in their use, so that the efficiencies we have identified become normal business practice.

BPA is financially sound. We continue to make improvements in our internal governance. We are ready to address our next challenges in serving the people of the Pacific Northwest.

PERFORMANCE MEASURES

Each year since 1996, BPA has selected a set of measurable targets that the agency as a whole is responsible for achieving. These act as indicators of overall agency performance and are used in evaluating agency management. In fiscal year 2006, BPA met 24 of its 26 targets and partially met the other two.

Stakeholder Perspective

Transmission system

Target met. BPA exceeded the target to meet 12 of 14 milestones by completing 13 of the 14 on schedule and within budget.

Hydro generation system

Target met. Generation was increased by 4.5 average megawatts through the hydro efficiencies program by Sept. 30, 2006, and was accomplished within budget. Two units at Grand Coulee Dam achieved 2.25 average megawatts of increased generation each from new turbine runner installations.

Energy efficiency/demand management

Target met. BPA achieved 44 average megawatts of new conservation savings, meeting the target of 36 to 44 average megawatts and doing so at a cost of $1.45 million per average megawatt. New conservation augmentation savings were obtained at a cost of $1.1 million per average megawatt.

Transmission reliability

Target met. There were no involuntary curtailments of firm load due to a transmission system security breach or to cascading outages originating on the BPA system. BPA also met the target compliance requirements for the Western Electricity Coordinating Council's Reliability Management System.

Generation reliability

Target met. There were no involuntary curtailments of firm load due to inadequate power supply or a breach of generation system security. BPA also met the target compliance requirements for the Western Electricity Coordinating Council's Reliability Management System for power system stabilization and automatic voltage regulation.

Transmission availability

Target met. BPA's most important transmission lines were available for service 98.8 percent of the time, exceeding the target of 98 percent.

Generation availability

Target met. BPA achieved 98.4 percent heavy load hour availability, exceeding the target of 97 percent.

Congestion management strategy

Target met. BPA worked with the region to develop a strategy to manage congestion on the transmission grid. BPA's Congestion Management Steering Committee approved workgroup recommendations in August. In September, the committee tested the recommendation at a regional customer meeting, and BPA then formally approved the plan.

Regional Dialogue process

Target partially met. The Regional Dialogue policy proposal was released for public review and comment on July 13. At the joint request of public customers and investor-owned utilities, BPA extended the public comment period on the Regional Dialogue policy proposal for 30 days to Oct. 31. BPA extended the comment period to allow more time for parties to reach a settlement on investor-owned utility benefits for the 20-year term of the Regional Dialogue contracts, although this meant the targeted schedule was not met.

Power rates

Target met. BPA filed its FY 2007-2009 wholesale power rates with the Federal Energy Regulatory Commission on July 28, 2006, that resulted in a three-year average expected power rate of $27.2 per megawatt-hour. This was on time and well within the target range of $26.8 to $28.3 per megawatt-hour (the start-of-year range of $28 to $29.5 per megawatt-hour was adjusted per the target's requirement to reflect changes in net secondary revenues, financial impacts of court-ordered fish and wildlife actions and reactive credit).

ESA compliance long-term action plan

Target partially met. BPA collaborated with Northwest states and tribes on development of a proposed action for operation of the FCRPS and "all-H" actions in habitat, hatcheries and harvest to mitigate for the effects of the FCRPS under the Endangered Species Act as ordered by the Oregon Federal District Court in the remand of the 2004 Biological Opinion. Collaboration also occurred on an analytical framework and methods for performing the biological analysis of the proposed action.

Customer satisfaction

Target met. Survey results showed a customer satisfaction rating of 7.8, exceeding the target of 7.0 to 7.5.

Constituent satisfaction

Target met. Survey results showed a constituent satisfaction rating of 7.7, exceeding the target of 7.0 to 7.5.

Tribal government satisfaction

Target met. Survey results showed a tribal government satisfaction rating of 6.6, exceeding the target of 6.0 to 6.5.

Financial Perspective

Modified net revenues

Target met. BPA's modified net revenues for FY 2006 were $445 million, substantially exceeding the target range of $135 million to $240 million. The primary reasons for this were the price and volume of secondary sales that resulted from better than average runoff and higher prices than projected at the beginning of the year.

Treasury payment

Target met. BPA's FY 2006 payments to Treasury of $1.113 billion were made on time and in full for the 23rd consecutive year.

Debt optimization

Target met. BPA achieved this target with completion of the Energy Northwest/BPA bond sale for debt optimization refinancing of $204 million in the third quarter and the prepayment of $337 million for early federal debt amortization on Sept. 30.

Bond rating

Target met. BPA has maintained ratings of "AA-" or better from all three rating agencies for BPA-backed bonds during FY 2006 (S&P AA-; Fitch AA-; Moody's Aaa).

Internal Operations Perspective

Internal operating costs

Target met. Overall expenditures (including capital and expense) were $491.9 million, representing 94 percent of the start-of-year budget.

Internal controls review

Target met. BPA successfully met the requirements of the Office of Management & Budget's Circular A-123, Appendix A, to demonstrate appropriate controls on financial reporting.

Process improvement

Target met. BPA is pursuing major multi-year process improvements in key functions to achieve improved efficiency and effectiveness. BPA is on schedule to meet targeted project milestones for seven functional areas, including Public Affairs, Human Resources, Transmission Plan/Design/Build, Asset Management, Marketing and Sales, Supply Chain and Energy Efficiency.

Organization and governance

Target met. The agency implemented a new organizational structure on Oct. 1, 2006, which realigned key functions and strengthened governance and internal controls.

People and Culture Perspective

President's Management Agenda

Target met. BPA achieved four green ratings and one yellow (caution) rating for BPA's five President's Management Agenda initiatives.

Employee understanding of business strategy

Target met. Based on an annual employee survey, 82 percent confirmed that they understand BPA's business strategy, exceeding the target range of 70 to 80 percent.

Safety

Target met. BPA achieved a lost time accident frequency rate of 1.1 per 200,000 hours worked, well within the target range of 1.1 to 1.5 (lower is better) and 54 percent lower than the utility industry average of 2.4. There were no fatal injuries to BPA employees or contract employees working on BPA facilities.

Effective feedback

Target met. Based on an annual employee survey, 82 percent confirmed that they continue to be aligned with BPA's mission and business strategy through effective feedback, exceeding the target range of 70 to 80 percent.

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION & ANALYSIS

General

The Federal Columbia River Power System (FCRPS) combines the accounts of the Bonneville Power Administration (BPA), the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation) and the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan Facilities. Northwest Infrastructure Financing Corporation, a "Special Purpose Corporation," is consolidated with BPA.

BPA was created by an act of Congress in 1937 to market electric power from the Bonneville Dam located on the Columbia River and to construct facilities necessary to transmit such power. Congress has since designated BPA to be the marketing agent for power from all of the federally owned hydroelectric projects in the Pacific Northwest. BPA, whose headquarters are located in Portland, Oregon, is one of four regional federal power marketing administrations within the U.S. Department of Energy. Many of BPA's statutory authorities are vested in the Secretary of Energy, who appoints, and acts by and through, the BPA administrator. Some other authorities are vested directly in the BPA administrator.

BPA's primary enabling legislation includes the following federal statutes: the Bonneville Project Act of 1937; the Flood Control Act of 1944; Public Law 88-552 — the Regional Preference Act; the Federal Columbia River Transmission System Act of 1974; and the Northwest Electric Power Planning and Conservation Act of 1980 (Northwest Power Act). Today BPA markets electric power from 31 federal hydroelectric projects, most of which are located in the Columbia River Basin and all of which are owned and operated either by the Corps or Reclamation. These projects have an expected aggregate output of roughly 9,000 average megawatts under median water conditions. BPA has acquired all of the generating capability of Energy Northwest's Columbia Generating Station (CGS) nuclear power plant. The contract to acquire the generating capability of the project requires BPA to pay all or part of the annual project budget, including operating expense and debt service. BPA also acquired all of the output of the Cowlitz Falls hydro project and agreed to pay the operating expense and debt service. BPA sells, purchases and exchanges firm power, nonfirm energy, peaking capacity and related power services. BPA also constructs, operates and maintains a high-voltage transmission system comprising approximately three-fourths of the bulk transmission capacity in the Pacific Northwest. BPA uses this transmission capacity to deliver power to its customers and makes transmission capacity available to other utilities and power marketers.

BPA's primary customer service area is the Pacific Northwest region of the United States, encompassing the states of Idaho, Oregon, Washington, western Montana, and small parts of eastern Montana, western Wyoming, northern Nevada, Utah and northern California. BPA estimates that the population of the 300,000 square mile service area is just under 12 million people. Electric power sold by BPA accounts for about 35 percent of the electric power consumed within the region. BPA markets the majority of this power to over 100 publicly owned and cooperatively owned utilities for resale to consumers in the region. BPA also has contracts to sell power for direct consumption to a small number of companies (direct-service industries or DSIs) located in the region, although the contracted amount of service BPA provides to DSIs has diminished substantially relative to levels from the 1940s through the 1990s. BPA is required by law to exchange power with qualifying utilities to meet their residential and small farm electric power loads within the region. The operation of this program, referred to as the "Residential Exchange Program," may result in payments by BPA to the exchanging utilities if the applicable power rates for FCRPS power are lower than the utilities' respective average system cost of meeting their residential and small farm power loads. The primary participants in the Residential Exchange Program historically have been investor-owned utilities (IOUs) in the region.

The Transmission System Act placed BPA on a self financing basis, meaning that BPA pays its costs from revenues it receives from the sale of power and the provision of transmission and other services. BPA sets rates at levels to ensure revenues that recover BPA's costs, including certain payments to the U.S. Treasury. BPA's rates for the foregoing services are subject to approval by the Federal Energy Regulatory Commission (FERC) on the basis that, among other things, they recover BPA's costs. BPA issues and sells bonds to the U.S. Treasury and uses the proceeds to fund certain activities established under federal law.

With the Energy Policy Act of 1992, BPA was required to provide open access, nondiscriminatory transmission service to all requestors using pro forma tariffs as approved by FERC. While BPA is a single legal entity, it conforms to FERC standards of conduct to ensure its transmission function does not discriminatorily advantage its merchant power function.

BPA's cash receipts from all sources, including from both its transmission and power marketing businesses, must be deposited in the BPA fund, which is a revolving fund account of the U.S. Treasury and which is available to pay BPA's costs. In accordance with the Transmission System Act, BPA must make expenditures from the BPA fund as included in annual budgets submitted to Congress, without further appropriation and without fiscal year limitation, but within such specific directives or limitations as may be included in appropriation acts, for any purpose necessary or appropriate to carry out the duties imposed upon BPA pursuant to law.

BPA is required to make certain annual payments to the U.S. Treasury. These payments are subject to the availability of net proceeds, which are gross cash receipts remaining in the BPA fund after deducting all of the costs paid by BPA to operate and maintain the FCRPS other than those used to make payments to the U.S. Treasury for: the repayment of the federal investment in certain transmission facilities and the power generating facilities at federally owned hydroelectric projects in the Pacific Northwest; debt service on bonds issued by BPA and sold to the U.S. Treasury; repayments of appropriated amounts to the Corps and Reclamation for certain costs allocated to power generation at federally owned hydroelectric projects in the Pacific Northwest; and costs allocated to irrigation projects as are required by law to be recovered from power sales.

The requirement to pay the U.S. Treasury exclusively from net proceeds would result in a deferral of U.S. Treasury payments if net proceeds were not sufficient for BPA to make its payments in full to the U.S. Treasury. Such deferrals could occur in the event that BPA were to receive less revenue or if its costs were higher than expected. Such deferred amounts, plus interest, must be paid by BPA in future years. BPA has not deferred such payments since 1983.

Rates

During the rate period from fiscal year 2002 to 2006, BPA had three Cost Recovery Adjustment Clauses (CRACs) in its power rates that were designed to collect additional power revenues to ensure that BPA had sufficient funds to meet its obligations, including repayment to the U.S. Treasury. The three CRACs included a Load-Based (LB) CRAC, a Financial-Based (FB) CRAC and a Safety-Net (SN) CRAC.

The LB CRAC was a percentage rate adjustment and was based on BPA's costs to purchase power to meet load obligations. Because BPA acquires some portions of this power in a highly volatile market, it was not possible to accurately forecast the cost of power purchases over the entire five-year rate period. Accordingly, the LB CRAC was designed to respond to changes in the market price of power and to reflect the change in prices in the fixed power purchase contracts. It was reset every six months to recover the anticipated augmentation costs to meet load that could not be recovered with the base rates. The FB CRAC triggered if forecast accumulated power net revenues fell below a threshold value for a particular year. The SN CRAC was designed to raise rates if a payment to the U.S. Treasury or other creditor was missed, or if the administrator projected a 50 percent probability that such a payment might be missed in the then-current fiscal year.

Under BPA's proposed rates effective Oct. 1, 2006, these CRACs have been replaced with a comprehensive set of rate adjustment tools centered on a single CRAC mechanism.

Customers

BPA sells power (energy and capacity) and related services to four main types of customers: Northwest publicly owned utilities, DSIs, Northwest IOUs, and other regional and extra regional customers. BPA also sells relatively small amounts of power to several federal agencies within the region. The revenue derived from these customers provides BPA with a large portion of the funds needed to pay its costs. BPA sells transmission and related services under open access tariffs to a broad variety of power generators, including wind generators, marketers and power purchasers.

Sales Within the Northwest Region

Northwest Publicly Owned Utilities

Qualifying public utility districts, municipalities and consumer-owned electric cooperatives within the region are entitled to a statutory preference and priority in the purchase of available FCRPS power. By law, these customers have what is referred to as "public preference." They are eligible to purchase power at BPA's priority firm rate for most of their loads. As a group, publicly owned utilities constitute BPA's largest customer base in terms of number, megawatt-hour sales and revenues.

Direct-Service Industries

BPA is not required to do so, but may offer to sell power for direct consumption to a limited number of existing DSIs within the region.

Northwest Investor-Owned Utilities

BPA provides some firm power to Northwest IOUs. This is power not sold under the public preference priority rate. BPA also sells substantial amounts of peaking capacity to Northwest IOUs during weather extremes. As part of its Subscription strategy, BPA entered into certain agreements, as amended, with the Northwest IOUs to settle BPA's statutory obligation to provide benefits under the Residential Exchange Program for specified periods that began Oct. 1, 2001.

Revenues by Customer Class

Federal Columbia River Power System
For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Sales of electric power:			
Sales within the Northwest region			
Northwest publicly owned utilities	$1,711,889	$1,717,063	$1,737,895
Direct-service industries	80,021	82,454	92,424
Northwest investor-owned utilities	502,601	390,511	363,201
Sales outside the Northwest region	691,508	600,765	489,063
Bookouts	(220,911)	(238,847)	(212,155)
Total sales of electric power	2,765,108	2,551,946	2,470,428
Transmission	641,132	527,383	535,936
Other revenues	(63,224)	131,054	114,547
U.S. Treasury credits for fish	76,353	57,700	77,000
Total operating revenues	$3,419,369	$3,268,083	$3,197,911

Revenues from Northwest IOUs fluctuate with streamflows in the Columbia River Basin. Streamflows directly impact the amount of surplus power available for sale, the costs of generating power with alternative fuels and ultimately the price BPA can obtain for these sales.

Sales Outside the Northwest Region

BPA sells some surplus power to various extra regional buyers which is in excess of what is needed to serve firm load obligations in the region. Revenue from these sales fluctuate with streamflows in the Columbia River Basin. Streamflows directly impact the amount of surplus power available for sale, the costs of generating power with alternative fuels and ultimately the price BPA can obtain for these sales.

Bookouts

In fiscal year 2004, BPA's total operating expenses and revenues from electricity sales reflected for the first time the impacts of new accounting guidance from the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB). Under this guidance (referred to herein as "EITF 03-11"), which BPA adopted as of Oct. 1, 2003, both revenues and expenses associated with non-trading energy activities that are "booked out" (settled other than by the physical delivery of power) are to be reported on a "net" basis in both operating revenues and purchased power expense. Formerly, such bookouts were to be treated on a "gross" basis. Application of the new guidance thus decreased both operating revenues from power sales and purchase power expense in fiscal years 2006, 2005 and 2004 by $221 million, $239 million, and $212 million, respectively, from what they otherwise would have been absent application of the guidance. The accounting treatment under EITF 03-11 has no effect on net revenue, cash flows or margins.

Transmission

Transmission revenues fluctuate with weather conditions within and outside of the region, hydro conditions related to secondary power sales, and outage requests for construction and maintenance purposes. Over the past few years, secondary sales of transmission service have grown. BPA's Transmission Services is required to provide transmission service to generators and marketers under the same open access tariffs it uses to charge BPA's Power Services and other transmission customers.

Other Revenues

Derivative mark-to-market accounting adjustments and other power miscellaneous revenues are included in this category.

U.S. Treasury Credits for Fish

The Northwest Power Act obligated BPA to make expenditures for fish and wildlife protection, mitigation and enhancement for both power and non-power purposes, on a reimbursement basis. The Northwest Power Act also specified that consumers of electric power, through their rates for power services "shall bear the costs of measures designed to deal with adverse impacts caused by the development and operation of electric power facilities and programs only." Section 4(h)(10)(C) of the Northwest Power Act was designed to ensure that the costs of mitigating these impacts are properly accounted for among the various purposes of the hydroelectric projects. In the early 1990s, BPA, the U.S. Treasury and the Office of Management and Budget agreed to a crediting mechanism whereby BPA reduces its payments to the U.S. Treasury by an amount equal to the mitigation measures funded on behalf of the non-power purposes.

Liquidity and Capital Resources

At Sept. 30, 2006, the FCRPS ending cash balance on the Combined Balance Sheet was $1.225 billion. The Corps and Reclamation combined cash balances were $120 million.

BPA's year-end cash was $1.105 billion and deferred borrowing authority was $88 million, the sum of which equals BPA's reserves of $1.193 billion. Deferred borrowing represents amounts that BPA is authorized to borrow from the U.S. Treasury for expenditures that BPA has incurred but has not borrowed for to date. For fiscal years 2005 and 2004, BPA's year-end cash and deferred borrowing authority were $548 million and $6 million, and $587 million and $51 million, respectively.

Operating Activities

Cash provided by operating activities of the FCRPS increased $636 million to $1.313 billion for the year ended Sept. 30, 2006, compared to $677 million for the year ended Sept. 30, 2005. Better than average precipitation and streamflows and strong market prices contributed to higher net revenues in fiscal year 2006.

Additionally, in fiscal year 2006, BPA and Energy Northwest entered into a new financial arrangement. Under the new direct-pay arrangement, Energy Northwest's cash flow needs are funded by BPA each month as needed. This improves BPA's liquidity, which contributed to a reduction in wholesale power rates from what they otherwise would have been beginning Oct. 1, 2006, by about $1.50 per megawatt-hour. About $250 million of BPA's reserves at the end of fiscal year 2006 resulted from the cash flow shift generated by the new arrangement.

Cash provided by operating activities increased $11 million to $677 million for the year ended Sept. 30, 2005, compared to $666 million for the year ended Sept. 30, 2004.

For both periods, the change in operating cash flow reflects differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities.

Investment Activities

Cash used for investment activities decreased $46 million to $448 million for the year ended Sept. 30, 2006, reflecting lower capital expenditures for federal utility plant and the reclassification of conservation and fish and wildlife to other cash provided by operating activities when compared to the prior year.

Cash used for investment activities of the FCRPS decreased $152 million to $494 million for the year ended Sept. 30, 2005, primarily from lower capital expenditures for federal utility plant, when compared to the prior year. The decrease was primarily a result of the reduction in such expenditures upon completion of transmission projects including Coulee-Bell and substantial completion of the Schultz-Wautoma project in the year ended Sept. 30, 2005.

Financing Activities

BPA manages the FCRPS debt portfolio to meet the objectives of: (1) minimizing the cost of debt to BPA's ratepayers; (2) maximizing BPA's access to its lowest cost capital sources to meet future capital needs at the lowest cost to ratepayers; and (3) maintaining sufficient financial flexibility to handle BPA's financial requirements.

In the spring of 2000, BPA presented a "Debt Optimization Program" to Energy Northwest. The BPA program, which was agreed to by Energy Northwest, involves the extension of the final maturity of debt issued for the CGS. In September 2001, Energy Northwest's Executive Board adopted an updated refunding plan that incorporated an increase in the average life of outstanding bonds issued for Energy Northwest Nuclear Project Nos. 1 and 3 as a refinancing program objective.

Implementing the BPA program is intended to provide BPA with cash flow flexibility to allow BPA to advance the repayment of BPA's high interest federal debt and to reduce BPA's overall fixed costs. Under the BPA program through Sept. 30, 2006, approximately $2.0 billion in bonds issued by Energy Northwest have been refinanced with new bonds having final maturities in calendar years 2013-2024. BPA expects that Energy Northwest will continue to pursue similar refinancing opportunities through at least fiscal year 2009. As a result of the actions taken under the BPA program, BPA prepaid appropriations and outstanding bonds issued to the U.S. Treasury of $337 million, $313 million and $346 million in fiscal years 2006, 2005 and 2004, respectively. Of the $337 million in Treasury prepayments in fiscal year 2006, about $204 million, $73 million and $60 million of such prepayments arose from Debt Optimization Program refinancing by Energy Northwest in fiscal years 2006, 2005 and 2002, respectively.

In addition to refinancing actions under the BPA program in fiscal year 2006, Energy Northwest issued $338 million in bonds to extend CGS debt into 2020-2024 for rate relief; $312 million in bonds for refinancing savings; and also issued $66 million in bonds to finance certain capital improvements at CGS during Energy Northwest fiscal years 2006 and 2007.

In fiscal year 2005, BPA, through Energy Northwest, restructured approximately $273 million in nonfederal debt. In addition, Energy Northwest issued $92 million in new debt to meet future fuel needs for the CGS reactor. Also, the City of Eugene, Oregon, acting by and through the Eugene Water and Electric Board issued $27 million solely as an economic refunding to lower debt service, and not as part of the BPA program.

Credit Ratings

BPA maintained high credit ratings on nonfederal debt backed by BPA with the three bond rating agencies covering BPA. In fiscal year 2006, Moody's maintained its credit rating on BPA-backed third party bonds at Aaa, and

Standard & Poor's and Fitch maintained their ratings on BPA-backed third party bonds at AA minus.

Treasury Payment

BPA paid the U.S. Treasury $1.113 billion for fiscal year 2006, making it the 23rd consecutive year in which BPA has made its payments on time and in full. The fiscal year 2006 payments included $646.2 million in principal and $390.6 million in interest for bonds issued to the U.S. Treasury and for the appropriated federal investment in the FCRPS. BPA also paid the U.S. Treasury $76.1 million in other obligations, including $23.2 million of additional funding for post-retirement benefit programs provided to employees associated with the operation of the FCRPS. Payments made in fiscal years 2005 and 2004 were $1.088 billion and $1.053 billion, respectively. This year's principal payment also included $337.1 million to repay federal appropriations and bonds issued to the U.S. Treasury in excess of those scheduled in FERC filings.

BPA Borrowing Authority

The aggregate principal amount of bonds BPA is authorized to sell to the U.S. Treasury and to have outstanding at any one time is $4.45 billion. Of the $4.45 billion in borrowing authority that BPA has with the U.S. Treasury, $2.48 billion of bonds were outstanding as of Sept. 30, 2006. Under current law, none of this U.S. Treasury borrowing authority may be used to acquire electric power from a generating facility having a planned capability of more than 50 average megawatts. Of the $4.45 billion in U. S. Treasury borrowing authority, $1.25 billion is available for renewable resources and conservation purposes and $3.2 billion is available for BPA's transmission program and to implement BPA's authorities under the Northwest Power Act.

The interest on BPA's outstanding bonds issued to the U.S. Treasury is set at rates comparable to the rates prevailing in the market for similar bonds issued by government corporations. As of Sept. 30, 2006, the interest rates on the outstanding bonds ranged from 2.5 percent to 8.55 percent with a weighted average interest rate of approximately 5.1 percent. The terms of the outstanding bonds vary from 3 to 34 years. The term of the bonds is limited by the average expected service life of the associated investment or 50 years, whichever is less. The average expected service life is 40 years for transmission facilities, 75 years for Corps and Reclamation capital investments, up to 20 years for conservation investments, and 15 years for fish and wildlife projects. Bonds can be issued with call options. At Sept. 30, 2006, BPA had seven callable bonds on its books totaling $353.9 million.

Contractual Obligations and Federal Payments

As of Sept. 30 — thousands of dollars

	2007	2008	2009	2010	2011	Thereafter	Total
Federal appropriations*	$ 300,112	$ 274,979	$ 273,189	$ 288,929	$ 281,967	$10,304,816	$ 11,723,992
Bonds issued to U.S. Treasury*	677,107	578,875	516,201	200,470	164,495	1,431,880	3,569,028
Nonfederal projects debt*	593,038	625,706	609,649	593,293	609,953	6,246,050	9,277,689
IOU exchange benefits**	324,840	324,839	324,840	124,839	124,840	—	1,224,198
Asset retirement obligations*	7,869	8,608	9,352	10,195	11,147	344,317	391,488
DSI benefits	59,000	59,000	59,000	—	—	—	177,000
Purchase power commitments	109,835	60,306	61,444	33,616	33,597	—	298,798
Irrigation assistance	—	2,950	7,211	—	—	671,349	681,510
Additional post-retirement**	21,100	18,000	30,554	31,195	32,142	—	132,991
Total contractual obligations	$2,092,901	$1,953,263	$1,891,440	$1,282,537	$1,258,141	$18,998,412	$27,476,694

*Amounts shown include interest.

**Estimates for amounts thereafter are not available.

Federal appropriations, bonds issued to U.S. Treasury, nonfederal projects debt, IOU exchange benefits, asset retirement obligations and DSI benefits are reflected in the Combined Balance Sheets and discussed in the accompanying Notes to Financial Statements, Notes 3 through 6. Purchase power commitments and additional post-retirement contributions are period expenses, and irrigation assistance is treated as a distribution from accumulated net revenues when paid. These are discussed in Note 7 Commitments and Contingencies.

Total contractual obligations decrease approximately $600 million between the power rate period which ends on Sept. 30, 2009, and the 2010-2011 rate period primarily due to the changes in amounts for bonds issued to U.S. Treasury, and estimated IOU exchange and DSI benefits.

The bonds issued to U.S. Treasury are scheduled by maturity date. Because IOU exchange benefits for 2010 and 2011 cannot be reasonably estimated under Statement of Financial Accounting Standards (SFAS) 5, “Accounting for Contingencies,” until the 2010-2011 rate case process begins, the floor of $100 million per year has been recorded for 2010 and 2011 versus the cap of $300 million per year for the 2007-2009 rate period. In accordance with the contract, the benefits for 2010 and 2011 will be calculated when the Forward Flat-Block Price Forecast is available. DSI benefits for 2010 and 2011 are not estimated because BPA has the option to revert to a physically delivered surplus firm power sale for the 2010-2011 rate period.

Results of Operations

2006 Compared to 2005

As reported in the Combined Statement of Revenues and Expenses which follows, for the fiscal year ended Sept. 30, 2006, FCRPS total operating revenues were $3.419 billion, an increase of $151 million from the prior fiscal year. Revenues from electricity and transmission sales for the fiscal year ended Sept. 30, 2006, increased $318 million from one year earlier. Both Power and Transmission revenues increased as reported in the Segment Reporting statements. Power revenues increased due to higher spot market power sales enabled by increased runoff. Transmission revenues also increased due to the load growth and increased surplus power sales discussed above and from an Oct. 1, 2005, rate increase of approximately 12 percent leading to higher revenues for the current year. SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," derivative mark-to-market amount for the fiscal year ended Sept. 30, 2006, decreased $195 million when compared to the prior year due to a drop in the forward prices, physical delivery and a change in the overall portfolio mix.

In total, operating expenses increased $43 million, or 2 percent, from fiscal year 2005. Operations and maintenance increased $64 million, or 5 percent, for the fiscal year from the comparable period a year earlier. The increase was a result of a number of factors. Transmission Services' reimbursable work increased; Power Services' contracts, agreements and grants increased and direct funding for federal hydro costs increased. Purchased power decreased $45 million, or 8 percent compared to the year ended Sept. 30, 2005. Market prices for power were lower during fiscal year 2006 than levels in fiscal year 2005, and megawatts of power purchased were also about 17 percent lower compared to the prior year. Power purchases were lower due to higher hydro generation and expiring augmentation contracts. Nonfederal projects' debt service expense increased $46 million, or 16 percent, primarily due to higher debt service expense for Energy Northwest's Nuclear Project Nos. 1 and 3. The increase is the result of planned payment scheduling for nonfederal debt within the total FCRPS debt portfolio. The overall objective of debt management actions is to achieve the optimal total debt portfolio. The portfolio includes federal appropriations, bonds issued to the U.S. Treasury and nonfederal projects debt. Portfolio management causes nonfederal debt to fluctuate between years. Federal projects' depreciation and amortization decreased $22 million, or 6 percent reflecting new depreciation rates effective Oct. 1, 2005, for transmission services and lower expense for the Corps.

Net interest expense for the fiscal year ended Sept. 30, 2006, decreased $16 million, or 6 percent, compared to a year ago. Interest on appropriated funds owed the U.S. Treasury increased $13 million or 7 percent. Interest on bonds issued to the U.S. Treasury decreased $17 million or 17 percent as the weighted average interest rate declined from 4.9 percent at the beginning of fiscal year 2005 to 4.8 percent at the beginning of fiscal year 2006. Interest expense on bonds also decreased as the income earned on BPA's cash account at the U.S. Treasury increased $11 million with higher cash balances since BPA reports this interest expense net of the interest income earned. Interest expense decreased as allowance for funds used during construction increased $12 million or 69 percent.

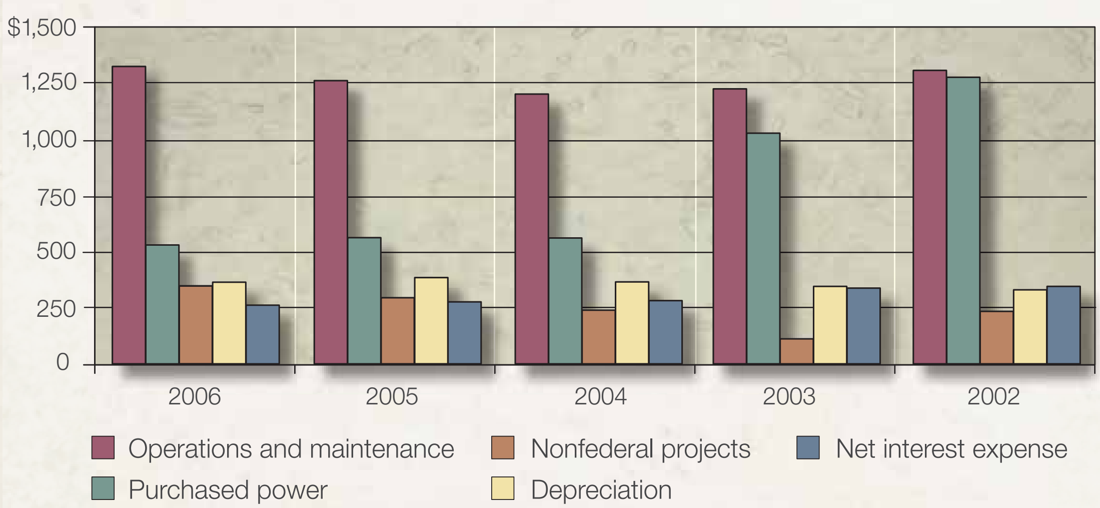
2005 Compared to 2004

For the fiscal year ended Sept. 30, 2005, total operating revenues were $3.268 billion, an increase of $70 million from the previous year. Revenues from electricity and transmission sales increased approximately $78 million from the fiscal year 2004 levels. The increased revenues from electricity and transmission sales resulted from higher sales of surplus power outside the region. SFAS 133, "Accounting for Derivative Instrument and Hedging Activities," derivative mark-to-market amount increased $5 million, miscellaneous revenues increased $6 million and U.S. Treasury credits for fish under Northwest Power Act section 4(h)(10)(C) decreased $19 million, when compared to the prior year.

In total, operating expenses increased $95 million, or 4 percent, when compared to the prior year. Operations and maintenance increased $45 million, or 4 percent. This increase reflects the effects of higher operating costs at the CGS of $21 million, mainly for nuclear fuel, and increased payments of IOU exchange benefits of $18 million. Operating expenses also reflect that purchased power decreased $2 million, or less than 1 percent, compared to the fiscal year ended Sept. 30, 2004, and that nonfederal projects debt service expense increased $43 million, or 17 percent. The nonfederal project debt service expense in-

Expenses by Category

millions of dollars



creased in part because the Energy Northwest fiscal year 2004 operating budgets included approximately $79 million that was made available when reserve funds for certain Energy Northwest net-billed bonds were replaced with surety agreements. The surety agreements were used to reduce fiscal year 2004 net-billing requirements for nonfederal projects' debt service. In addition, federal projects' depreciation increased $9 million, or 3 percent, primarily due to the energization of the Grand Coulee-Bell transmission line.

Net interest expense for the year ended Sept. 30, 2005, decreased $8 million, or 3 percent, compared to the prior year. Interest on appropriated funds decreased due to lower principal owed to the U.S. Treasury. Interest on bonds issued to the U.S. Treasury decreased as the weighted average interest rate declined from 5.3 percent at the beginning of fiscal year 2004 to 4.9 percent at the beginning of fiscal year 2005. This interest expense also decreased as the income earned on BPA's cash account at the U.S. Treasury increased with higher average cash balances. BPA reports interest expense on long-term debt net of the interest income earned. The decrease in interest expense was partially offset by decreased allowance for funds used during construction due to lower construction work-in-progress balances.

Net revenues were $487 million in fiscal year 2005, a decrease of $18 million, or 4 percent, from fiscal year 2004 as a result of the factors discussed above.

Fish and Wildlife

Fish and Wildlife

Federal Columbia River Power System
For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Estimated foregone power revenues	$397,000	$182,000	$ 22,000
Direct costs and replacement power purchases	354,000	394,000	479,000
Total fish and wildlife	$751,000	$576,000	$501,000

The Northwest Power Act directs BPA to protect, mitigate and enhance fish and wildlife resources to the extent they are affected by federal hydroelectric projects on the Columbia River and its tributaries. BPA makes expenditures and incurs other costs for fish and wildlife consistent with the Northwest Power Act and the Pacific Northwest Power and Conservation Council's Columbia River Basin Fish and Wildlife Program. In addition, in the wake of certain listings of fish species under the Endangered Species Act (ESA) as threatened or endangered, BPA is financially responsible for expenditures and other costs arising from conformance with the ESA and certain biological opinions prepared by the National Oceanic and Atmospheric Administration (NOAA) Fisheries and the U.S. Fish and Wildlife Service in furtherance of the ESA.

BPA typically funds fish and wildlife mitigation through several mechanisms. Since the creation of the FCRPS, BPA has repaid the U.S. Treasury the share of the costs of mitigation by the Corps and Reclamation that is allocated by law or pursuant to policies promulgated by FERC's predecessor to the federal projects' power purpose. These measures mitigate for the impact on fish and wildlife of the construction and operation of hydroelectric dams of the FCRPS.

BPA also implements and funds measures proposed in the Council program, which the Council periodically amends. The Council program calls for a variety of mitigation measures from habitat protection to mainstem Columbia River and Snake River flow targets. Such measures affect the operation for the FCRPS and require BPA to purchase power to fulfill contractual demands or to spill water and thereby forego generation of electricity. The financial impacts of these investments in fish and wildlife are counted as measures funded by BPA. Some of the Council program's measures, especially those designed to benefit species not listed under the ESA, are in addition to ESA-directed measures. However, with respect to the Council program measures for listed species, many of the measures identified in the FCRPS biological opinions and in the Council's program overlap. BPA uses a comprehensive approach to implementation described as "integrated," meaning the ESA requirements of the FCRPS biological opinions are incorporated with the broad fish and wildlife protection, mitigation and enhancement objectives of the Council program, consistent with the Northwest Power Act.

BPA's fish and wildlife costs fall into two main categories, direct costs and operational impacts.

Direct costs include integrated program costs, which are the costs to BPA of implementing the Council program, and which include expense and capital components for ESA-related and non-ESA-related measures that are located at sites away from the FCRPS dams; expenses for recovery of capital, which include depreciation, amortization and interest expenses for fish and wildlife capital investments by the Corps, Reclamation and BPA; and, other entities' operation and maintenance, which include fish and wildlife operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Hatcheries and of the Corps and Reclamation for FCRPS projects.

Operational impacts include replacement power purchase costs and estimated foregone power revenues. Replacement power purchase costs are the costs of certain power purchases made by BPA that are attributable to river operations in aid of fish and wildlife. To determine these costs in a given year, BPA compares the actual hydroelectric generation in the year against the hydroelectric generation that would have been produced had the hydroelectric system been operating without any fish and wildlife operating constraints. To the extent that this comparison indicates that BPA made a power purchase to meet load and it is a purchase BPA would not have had to make had the river been operated free of fish constraints, BPA accounts for such value as a fish and wildlife cost. Estimated foregone power revenues are revenues that would have been earned absent changes in hydroelectric system operations attributable to fish and wildlife.

Environmental Matters

From time to time, there are sites where BPA, Corps or Reclamation have been or may be identified as a potential responsible party. Costs associated with cleanup of those sites are not expected to be material to the FCRPS financial statements and would be recoverable through future rates.

Forward-Looking Information

President's Fiscal Year 2007 Budget

The President's fiscal year 2007 budget includes three proposals that, if implemented, may affect BPA. First, the budget proposes that, starting in fiscal year 2007, in any year that BPA earns net secondary revenues in excess of $500 million, BPA shall pay an amount equivalent to that excess to the U.S. Treasury as early payment toward Treasury bond debt. Net secondary revenues are the revenues (net of transmission and generation costs) that BPA derives from the sale of surplus power inside and outside of the Pacific Northwest. These revenues are highly variable depending on water availability and market prices. As proposed in the budget, no change in law would be required for BPA to implement the proposal regarding net secondary revenues. The budget proposal would have to be implemented in a BPA rate case proceeding. Since the President's budget was released, however, Congress passed a law that forbids BPA and other federal agencies from making any expenditure of funds prior to April 1, 2007, to make, or plan or prepare to make, any advance payment on BPA debt. This legislation allows time for dialogue within the region regarding this proposal before it is implemented and prohibits any actions on the part of BPA to begin implementation of the proposal.

Second, the budget references proposed legislation submitted by the Office of Management and Budget to Congress on June 1, 2005. If enacted, this legislation would convert the amount of BPA's Treasury borrowing cap into a cap on both Treasury borrowing and most third party financings by BPA. The proposal has not been introduced in Congress. Nonetheless, the proposal would only affect those transactions occurring after enactment of the legislation. In addition, the Department of Energy has agreed that the proposed legislation will not affect BPA's ability to participate in the refinancing of debt it secures pursuant to transactions that BPA entered into prior to the date the proposed legislation takes effect.

Third, the budget provides that in the next two years when Energy Northwest refinances bonds under the Debt Optimization Program, BPA will use the refinancing savings to make additional payments on its federal debt. In the past, in its budgets submitted to Congress, BPA has not assumed Energy Northwest refinancing savings or any additional associated payments until Energy Northwest estimates such savings through its budget process. While this is a different budget treatment than in the past, this treatment does not alter plans for BPA's Debt Optimization Program.

Although the President's fiscal year 2006 budget included a proposal for legislation "to very gradually bring [the federal power marketing administrations', including BPA's] electricity rates closer to average market rates throughout the country," the President's fiscal year 2007 budget did not. The administration currently is not actively pursuing this objective.

Fish and Wildlife

BPA expects to continue to support substantial fish and wildlife mitigation and protection costs in the future. BPA is unable to predict the future range of such costs.

Critical Accounting Policies

BPA's rates are designed to recover its cost of service. In connection with the rate-setting process, certain costs or credits may be included in rates for recovery over a period of time that differs from normal treatment under generally accepted accounting principles. Under those circumstances, regulatory assets or liabilities are recorded, and such costs or credits are amortized over the periods they are included in rates in accordance with SFAS 71, "Accounting for the Effects of Certain Types of Regulation."

In order to defer incurred costs under SFAS 71, a regulated entity must have the statutory authority to establish rates that recover all costs and rates so established must be charged to and collected from customers. BPA may be required to seek alternative solutions in the future to avoid raising rates to a level that is no longer competitive. If BPA's rates should become market-based, SFAS 71 would no longer apply, and any deferred costs and revenues under that standard would be expensed and recognized, respectively, in the Combined Statement of Revenues and Expenses in that period. BPA does not earn a rate of return on its regulatory assets.

See Notes 2 and 6, Other Assets and Other Liabilities, respectively, for tables summarizing regulatory assets and liabilities as of Sept. 30, 2006, and 2005. Amortization of these is reflected in the Combined Statements of Revenues and Expenses.

Modified Net Revenues

Federal Columbia River Power System
For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Net revenues	$ 611,063	$ 486,870	$ 504,415
SFAS 133 derivative mark-to-market loss (gain)	100,093	(94,596)	(89,452)
Nonfederal debt management actions	(266,249)	(266,139)	(348,636)
Modified net revenues	$ 444,907	$ 126,135	$ 66,327

Modified net revenues are net revenues after removing the effects of SFAS 133 and nonfederal debt management actions that differ from rate case assumptions. Management has determined that modified net revenues are a better representation of the outcomes of normal operations during periods of debt management actions and fluctuations in derivative market prices. Calculations similar to modified net revenues were developed as part of the power rates for the current period and were used to determine the thresholds for the FB and SN CRACs. The primary change in modified net revenues from fiscal year 2004 through fiscal years 2005 and 2006 is due to streamflows and market prices as discussed above.

Market Risk

Risk Management

BPA's Transacting Risk Management Committee has responsibility for the oversight of market risk and determines the risk policy and control environment at BPA. Experienced business and risk managers use the results of the hydro supply scenario and simulation analyses and the market price risk measures in conjunction with their professional judgment to capture additional market-related risks, including credit and event risk.

Due to both the operational risk posed by fluctuations in river flows affecting the hydroelectric generation supply capability and the commodity price risk, net revenues effects from underlying surplus or deficit energy positions are inherently uncertain.

Commodity Price Risk and Volumetric Risk

Primarily due to the periodic variation in the available energy from its hydroelectric generation capacity, BPA enters into short-term and forward sales and purchase agreements for electricity in the wholesale markets to balance its energy supply and demand. Fluctuations in the electric market prices in the Pacific Northwest can affect the value of energy inventory being bought and sold as well as the value of prior purchase and sale contracts. This is referred to as commodity price risk. In fiscal year 2006, there was a net surplus and sale of energy, which was in excess of that needed to serve firm load obligations in the region.

BPA measures the market price risk in its portfolio on a daily, weekly and monthly basis using net revenue at risk (NRaR), mark-to-market, value at risk (VaR), Monte Carlo simulation and other methodologies depending on the portfolio segment in question. The quantification of market risk using these methods provides a consistent measure of risk across the energy market in which BPA buys and sells. The use of these methods requires a number of key assumptions including hydro/price correlations, the selection of a confidence level for expected losses, the holding period for liquidation and the treatment of risks outside the methodology, including credit risk and event risk. These methods provide an estimate of reasonably possible net revenue outcomes that could be recognized on its portfolios assuming hypothetical movements in future market prices. In response to market price risk, futures, forwards, swaps and options may be used to alter BPA's exposure to price fluctuations.

Besides using market price risk measures, BPA measures the effects of volumetric risk using both scenario analysis and Monte Carlo simulation to estimate the economic impact of a sudden change in supply or price. Unlike many of its industry counterparts, BPA's principal market activity is the sale of surplus inventory rather than the purchase and sale of electricity to earn trading revenues. Therefore, the tests critical to trading organizations (i.e., amount of risk to carry over very short time frames) are considered less important than regular and rigorous analysis of the consequences of a range of hydro supply conditions and prolonged holding periods.

Credit Risk

Credit risk relates to the risk of loss that might occur as a result of non-performance by counterparties of their obligations to make or take delivery of electricity. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. During fiscal year 2006, BPA experienced no significant losses as a result of any customer defaults or bankruptcy filings. Credit risk is mitigated at BPA by reviewing counterparties for creditworthiness, establishing credit limits, and monitoring credit exposure on a daily basis, and performing Credit Value at Risk (CVaR) measurements for forward power transactions on a weekly basis. In order to further manage credit risk, BPA obtains credit support such as letters of credit and third-party guarantees from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly.

At Sept. 30, 2006, BPA had $79.7 million in credit exposure to purchase and sale contracts taking into account netting rights. BPA uses internally developed, commercially appropriate rating methodologies, credit scoring models, publicly available information and external ratings from major credit rating agencies to determine the public rating equivalent grade of counterparties. At Sept. 30, 2006, BPA's credit exposure, net of collateral, to sub-investment grade counterparties was less than 1 percent of total outstanding credit exposures. The agency's top five credit exposures were $63.2 million, or 80 percent, of the total credit exposure. The majority of this exposure is mark-to-market exposure arising from a term transaction with an "A" rated municipality with ratemaking authority.

Interest Rate Risk

BPA does not issue variable rate debt to the U.S. Treasury and is not exposed to substantive risk resulting from changes in interest rates as a result of its backing of the variable-rate debt issued by Energy Northwest. Of the $758 million of Energy Northwest variable rate debt outstanding at Sept. 30, 2006, $500 million has been effectively swapped into fixed rate debt as described in Note 1, Summary of Significant Accounting Policies. Under these swap agreements, BPA pays the counterparties a fixed rate and receives a variable rate which is 68 percent of LIBOR. Although not a perfect match, the amount BPA receives is intended to offset the variable rate paid on the $500 million in bonds issued by Energy Northwest. The remaining variable rate debt of approximately $258 million is partially matched against variable rate assets.

Selected Quarterly Information

Federal Columbia River Power System
3 months ended — thousands of dollars

	December 31	March 31	June 30	September 30	Totals
2006					
Revenues	$ 851,465	$ 932,877	$ 875,632	$859,488	$3,519,462
SFAS 133 mark-to-market	(32,969)	(22,888)	(19,833)	(24,403)	(100,093)
Operating revenues	818,496	909,989	855,799	835,085	3,419,369
Operating expenses	615,985	634,345	597,448	698,985	2,546,763
Net interest expenses	70,254	67,016	65,638	58,635	261,543
Net revenues	$ 132,257	$ 208,628	$ 192,713	$ 77,465	$ 611,063
2005					
Revenues	$ 776,805	$ 805,778	$ 701,765	$889,139	$3,173,487
SFAS 133 mark-to-market	(8,826)	15,040	1,914	86,468	94,596
Operating revenues	767,979	820,818	703,679	975,607	3,268,083
Operating expenses	587,015	622,066	642,559	652,289	2,503,929
Net interest expenses	71,491	70,697	67,442	67,654	277,284
Net revenues (expenses)	$ 109,473	$ 128,055	$ (6,322)	$255,664	$ 486,870
2004					
Revenues	$ 823,281	$ 755,437	$ 702,847	$826,894	$3,108,459
SFAS 133 mark-to-market	(1,210)	29,623	85,396	(24,357)	89,452
Operating revenues	822,071	785,060	788,243	802,537	3,197,911
Operating expenses	577,734	532,174	611,850	686,887	2,408,645
Net interest expenses	74,576	75,169	67,501	67,605	284,851
Net revenues	$ 169,761	$ 177,717	$ 108,892	$ 48,045	$ 504,415

FINANCIAL STATEMENTS

Combined Balance Sheets

Federal Columbia River Power System
As of Sept. 30 — thousands of dollars

ASSETS

	2006	2005
Federal utility plant		
Completed plant	$13,056,815	$12,722,386
Accumulated depreciation	(4,652,107)	(4,453,745)
	8,404,708	8,268,641
Construction work in progress	795,151	1,152,978
Net federal utility plant	9,199,859	9,421,619
Nonfederal generation	2,435,065	2,389,445
Current assets		
Cash	1,225,075	651,740
Accounts receivable, net of allowance	137,179	88,184
Accrued unbilled revenues	247,418	208,801
Materials and supplies, at average cost	71,765	75,073
Prepaid expenses	21,453	321,032
Total current assets	1,702,890	1,344,830
Other assets		
Regulatory assets	6,217,712	5,509,596
Nonfederal nuclear decommissioning trusts	140,896	125,509
Deferred charges and other	101,024	234,773
Total other assets	6,459,632	5,869,878
Total assets	$19,797,446	$19,025,772

The accompanying notes are an integral part of these statements.

CAPITALIZATION AND LIABILITIES

	2006	2005
Capitalization and long-term liabilities		
Accumulated net revenues	$ 1,945,357	$ 1,334,294
Federal appropriations	4,290,035	4,272,662
Bonds issued to U.S. Treasury	1,925,500	2,211,800
Nonfederal projects debt	6,284,379	6,286,559
Total capitalization and long-term liabilities	14,445,271	14,105,315
Commitments and contingencies (Note 7)		
Current liabilities		
Federal appropriations	33,694	68,939
Bonds issued to U.S. Treasury	556,300	565,000
Nonfederal projects debt	230,879	207,490
Accounts payable and other	369,597	322,497
Total current liabilities	1,190,470	1,163,926
Other liabilities		
Regulatory liabilities	2,072,362	2,129,660
IOU exchange benefits	1,224,198	984,187
Nonfederal nuclear asset retirement obligations	169,300	160,600
Deferred credits	695,845	482,084
Total other liabilities	4,161,705	3,756,531
Total capitalization and liabilities	$19,797,446	$19,025,772

The accompanying notes are an integral part of these statements.

Combined Statements of Revenues and Expenses

Federal Columbia River Power System
For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Operating revenues			
Sales	$ 3,370,432	$ 3,051,976	$ 2,973,496
SFAS 133 derivative mark-to-market	(100,093)	94,596	89,452
Miscellaneous revenues	72,677	63,811	57,963
U.S. Treasury credits for fish	76,353	57,700	77,000
Total operating revenues	3,419,369	3,268,083	3,197,911
Operating expenses			
Operations and maintenance	1,320,880	1,256,576	1,211,802
Purchased power	535,020	580,213	582,129
Nonfederal projects	337,627	291,540	248,475
Federal projects depreciation and amortization	353,236	375,600	366,239
Total operating expenses	2,546,763	2,503,929	2,408,645
Net operating revenues	872,606	764,154	789,266
Interest expense			
Interest on federal investment:			
Appropriated funds	204,979	192,110	213,041
Bonds issued to U.S. Treasury	85,078	102,077	110,251
Allowance for funds used during construction	(28,514)	(16,903)	(38,441)
Net interest expense	261,543	277,284	284,851
Net revenues	611,063	486,870	504,415
Accumulated net revenues at Oct. 1	1,334,294	847,424	343,748
Irrigation assistance	—	—	(739)
Accumulated net revenues at Sept. 30	$1,945,357	$1,334,294	$ 847,424

The accompanying notes are an integral part of these statements.

Combined Statements of Changes in Capitalization and Long-term Liabilities

Federal Columbia River Power System
Including current portions — thousands of dollars

	Accumulated net revenues	Federal appropriations	Bonds issued to Treasury	Nonfederal projects debt	Total
Balance at Sept. 30, 2004	$ 847,424	$4,443,961	$2,900,300	$6,453,828	$14,645,513
Federal appropriations:					
Increase for construction	—	75,642	—	—	75,642
Repayment of construction	—	(178,002)	—	—	(178,002)
Bonds issued to U.S. Treasury:					
Increase	—	—	315,000	—	315,000
Repayment	—	—	(438,500)	—	(438,500)
Nonfederal projects debt:					
Net increase	—	—	—	47,513	47,513
Repayment	—	—	—	(7,292)	(7,292)
Net revenues	486,870	—	—	—	486,870
Balance at Sept. 30, 2005	$1,334,294	$4,341,601	$2,776,800	$6,494,049	$14,946,744
Federal appropriations:					
Increase for construction	—	83,351	—	—	83,351
Repayment of construction	—	(101,223)	—	—	(101,223)
Bonds issued to U.S. Treasury:					
Increase	—	—	270,000	—	270,000
Repayment	—	—	(545,000)	—	(545,000)
Refinanced			(20,000)		(20,000)
Nonfederal projects debt:					
Increase	—	—	—	36,581	36,581
Repayment	—	—	—	(15,372)	(15,372)
Net revenues	611,063	—	—	—	611,063
Balance at Sept. 30, 2006	$1,945,357	$4,323,729	$2,481,800	$6,515,258	$15,266,144

The accompanying notes are an integral part of these statements.

Combined Statements of Cash Flows

Federal Columbia River Power System
For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Cash provided by operating activities			
Net revenues	$ 611,063	$ 486,870	$ 504,415
Non-cash items:			
Federal projects depreciation and amortization	353,236	375,600	366,239
Amortization of capitalization adjustment	(64,905)	(64,905)	(68,566)
(Increase) decrease in:			
Receivables and unbilled revenues	(87,612)	(47,394)	87,594
Materials and supplies	3,308	6,173	3,061
Prepaid expenses	299,579	10,351	(43,316)
(Decrease) increase in:			
Accounts payable and other	47,100	(16,370)	(30,954)
Other	151,323	(72,832)	(152,601)
Cash provided by operating activities	1,313,092	677,493	665,872
Cash used for investment activities			
Investment in:			
Federal utility plant (including AFUDC)	(402,474)	(424,735)	(576,324)
Nonfederal projects	(45,620)	(40,221)	(47,650)
Conservation	—	(14,825)	(16,876)
Fish and wildlife	—	(14,575)	(5,849)
Cash used for investment activities	(448,094)	(494,356)	(646,699)
Cash provided by and used for financing activities			
Federal construction appropriations:			
Increase	83,351	75,642	78,047
Repayment	(101,223)	(178,002)	(315,046)
Bonds issued to U.S. Treasury:			
Increase	270,000	315,000	480,000
Repayment	(545,000)	(438,500)	(277,454)
Refinanced	(20,000)	—	—
Nonfederal projects debt:			
Increase	36,581	47,513	179,130
Repayment	(15,372)	(7,292)	(11,895)
Irrigation assistance	—	—	(739)
Cash (used for) provided by financing activities	(291,663)	(185,639)	132,043
Increase (decrease) in cash	573,335	(2,502)	151,216
Beginning cash balance	651,740	654,242	503,026
Ending cash balance	$ 1,225,075	$ 651,740	$ 654,242
Cash paid for interest, net of U.S. Treasury credits	$ 256,787	$ 295,756	$ 290,290

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Principles of Combination

The Federal Columbia River Power System (FCRPS) combines the accounts of the Bonneville Power Administration (BPA), the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation) and the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan Facilities. Northwest Infrastructure Financing Corporation (NIFC), a "Special Purpose Corporation," is consolidated with BPA. See Note 5 Nonfederal Projects and Related Debt.

BPA is the power marketing administration that purchases, transmits and markets power for the FCRPS. Each of the foregoing entities is separately managed and financed, but the facilities are operated as an integrated power system with the financial results combined as the FCRPS. The costs of multipurpose Corps and Reclamation projects are assigned to specific functions through a cost-allocation process. Only the portion of total project costs allocated to power is included in these statements.

FCRPS accounts are maintained in accordance with generally accepted accounting principles and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission (FERC). FCRPS accounting policies also reflect specific legislation and executive directives issued by U.S. government departments. BPA is a unit of the U.S. Department of Energy; Reclamation and U.S. Fish and Wildlife Service are part of the U.S. Department of the Interior; and the Corps is part of the U.S. Department of Defense. U.S. government properties and income are tax-exempt. All material inter-company accounts and transactions have been eliminated from the combined financial statements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications were made to the fiscal years 2004 and 2005 Combined Statements of Cash Flows from amounts previously reported to conform to the presentation used in fiscal year 2006. Such reclassifications had no effect on previously reported results of operations and of cash flows.

Rates and Regulatory Authority

BPA's power and transmission rates are established in accordance with several statutory directives. Rates proposed by BPA are subjected to an extensive formal review process, after which they are proposed by BPA and reviewed by FERC. FERC's review is limited to three standards set out in the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act), 16 U.S.C. 839, and a standard set by the Energy Policy Act of 1992, 16 U.S.C. 824. FERC reviews BPA's rates for all firm power, non-firm energy and for transmission service. Statutory standards include a requirement that these rates be sufficient to assure repayment of the federal investment in the FCRPS over a reasonable number of years after first meeting BPA's other costs.

After final FERC approval, BPA's rates may be reviewed by the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit Court). Action seeking such review must be filed within 90 days of the final FERC decision. The Ninth Circuit Court may either confirm or reject a rate proposed by BPA. It is the opinion of BPA's General Counsel that, if a rate were rejected, it would be remanded to BPA for reformulation.

BPA submitted to FERC a Power Rate Filing in fiscal year 2001 for fiscal years 2002 through 2006. BPA submitted a Transmission and Ancillary Services Rate Filing in fiscal year 2003 for fiscal years 2004 through 2005 and in fiscal year 2005 for fiscal years 2006 through 2007. FERC granted final approval of the Power Rate Filing on July 21, 2003, 104 FERC 61,093 (2003). FERC granted final approval of BPA's Transmission and Ancillary Services Rate Filing for fiscal years 2004 through 2005 on Sept. 23, 2003, 104 FERC 62,207 (2003) and the Transmission and Ancillary Services Rate Filing for fiscal year 2006 through 2007 on Sept. 29, 2005, 112 FERC 62,258 (2005).

BPA rates for the sale of power pursuant to its contracts for the rate period ended Sept. 30, 2006, were subject to certain rate cost recovery adjustment clauses (CRACs) which were temporary upward adjustments to posted power prices if certain conditions occur. There were three CRACs in effect through Sept. 30, 2006, each triggered by a different set of conditions. The first was the Load-Based CRAC (LB CRAC), which triggered if BPA incurs costs for meeting or reducing loads that were not included in the rate case. The LB CRAC percentage changes every six months. The second was the Financial-Based CRAC (FB CRAC), which triggered if the generation function's forecast level of accumulated net revenues as modified in the General Rates Schedule Provisions (GRSP's) was below a predetermined threshold. The third was the Safety Net CRAC (SN CRAC), which was designed to trigger if BPA forecasted a 50 percent or greater probability of missing a payment to the U.S. Treasury or another creditor. Under BPA's proposed rates effective Oct. 1, 2006, these CRACs have been replaced with a comprehensive set of rate adjustment tools centered on a single CRAC mechanism.

BPA's rates are subject to the regulatory oversight described above and are designed to recover its cost of service. In connection with the rate-setting process, certain costs or credits may be included in rates for recovery over a period of time that differs from normal treatment under generally accepted accounting principles. Under those circumstances, regulatory assets or liabilities are recorded and such costs or credits are amortized over the periods they are included in rates in accordance with Statement of Financial Accounting Standards 71 (SFAS 71), "Accounting for the Effects of Certain Types of Regulation."

In order to defer costs under SFAS 71, a regulated entity must have the statutory authority to establish rates that recover all costs and rates so established must be charged to and collected from customers. BPA may be required to seek alternative solutions in the future to avoid raising rates to a level that is no longer competitive. If BPA's rates should become market-based, SFAS 71 would no longer be applicable, and any deferred costs and revenues under that standard would be expensed and recognized, respectively, in the Combined Statement of Revenues and Expenses in that period. Amortization of these costs is reflected in the Combined Statements of Revenues and Expenses. BPA does not earn a rate of return on its regulatory assets. See Notes 2 and 6 for Other Assets and Other Liabilities, respectively.

Federal Utility Plant

Federal utility plant is stated at original cost. Cost includes direct labor and materials; payments to contractors; indirect charges for engineering, supervision and similar overhead items; and an allowance for funds used during construction (AFUDC). The costs of additions, major replacements and betterments are capitalized. Repairs and minor replacements are charged to operating expense. The cost of federal utility plant retired is charged to accumulated depreciation when it is removed from service.

Asset Retirement Obligations

Under SFAS 143, "Accounting for Asset Retirement Obligations" (AROs), and clarified under Financial Accounting Standards Board (FASB) Interpretation 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement 143, if a tangible long-lived asset with an existing asset retirement obligation is acquired, a liability for that obligation is recognized at the asset's acquisition date as if the obligation were incurred on that date.

FCRPS has recognized AROs in accordance with SFAS 143 for legal obligations related to dismantlement and restoration costs associated with the retirement of tangible long-lived assets. Such obligations are recorded at fair value as increases in plant costs in the period in which the liability is incurred. While the net cost of removal (the difference between cost of removal and salvage) is included in depreciation rates, in the event there is negative salvage (the cost of removal exceeds salvage), a reclassification of any non-AROs negative salvage reserves is made from accumulated depreciation to a liability.

FIN 47 clarifies that an entity is required to recognize a liability for a legal obligation to perform an asset retirement activity if the fair value can be reasonably estimated even though the timing and (or) method of settlement are conditional on a future event. FCRPS recognizes the fair value of legal obligations associated with the retirement or removal of long-lived assets at the time the obligation is incurred using a reasonable estimate. The liability is accompanied by a corresponding increase in property, plant, and equipment. Subsequent to the initial recognition, the liability is adjusted for any revisions to the expected value of the retirement obligation and for accretion of the liability due to the passage of time.

BPA has certain tangible long-lived assets for which AROs are not measurable or there is no legal obligation to remove the asset. AROs will be required to be recorded for these assets if circumstances change. Assets that may require removal when no longer in service include the federal hydro projects.

Federal Projects Depreciation and Amortization

Depreciation of original cost and estimated cost to retire federal utility plant (i.e., net cost of removal) is computed on the straight-line method based on estimated service lives of the various classes of property, which average 40 years for transmission plant and 75 years for generation plant.

Amortization is for capitalized conservation and fish and wildlife costs. It is computed on the straight-line method based on estimated service lives, which are up to 20 years for conservation and 15 years for fish and wildlife.

Allowance for Funds Used During Construction

The allowance for funds used during construction constitutes interest on the funds used for utility plant under construction. AFUDC is capitalized as part of the cost of utility plant and results in a non-cash reduction of interest expense. While cash is not realized currently from this allowance, it is realized under the ratemaking process over the service life of the related property through increased revenues resulting from higher plant in-service and higher depreciation expenses. AFUDC is based on the monthly construction work in progress balance.

AFUDC capitalization rates are stipulated in the congressional acts authorizing construction for Corps and Reclamation generating projects and were 3.9 percent to 4.8 percent in fiscal year 2006, 2.1 percent to 4.9 percent in fiscal year 2005, and 1.3 percent to 5.3 percent in fiscal year 2004.

AFUDC capitalization rates for BPA's construction projects were approximately 4.8 percent in fiscal year 2006, 4.9 percent in fiscal year 2005, and 5.3 percent in fiscal year 2004. These rates approximate the cost of borrowing from the U.S. Treasury.

Nonfederal Generation

BPA has acquired all of the generating capability of Energy Northwest's Columbia Generating Station (CGS) nuclear power plant. The contract to acquire the generating capability of the project requires BPA to pay all or part of the annual project budget, including operating expense and debt service. BPA also has acquired all of the output of the Cowlitz Falls hydro project and pays all operating expense and debt service. BPA recognizes expenses for these projects based upon total project cash funding requirements. The nonfederal generation assets in the Combined Balance Sheets are amortized as the principal on the outstanding bonds is repaid. See Note 5 Nonfederal Projects and Related Debt.

Cash

For purposes of reporting cash flows, amounts include cash in the BPA fund and unexpended appropriations of the Corps and Reclamation.

Financial Instruments

The carrying value reflected in the Combined Balance Sheets approximates fair value for the FCRPS' financial assets and current liabilities. The fair values of bonds issued to U.S. Treasury and for nonfederal projects are discussed in Notes 4 and 5 for Bonds Issued to U.S. Treasury and Nonfederal Projects and Related Debt, respectively.

Concentrations of Credit Risks

General Credit Risk

Financial instruments, which potentially subject the FCRPS to concentrations of credit risk, consist primarily of BPA accounts receivable. Credit risk represents the loss that would be recognized if counterparties fail to perform as contracted.

BPA's accounts receivables are spread across a diverse group of public utilities, investor-owned utilities, power marketers, and others that are geographically located throughout the Western United States and Canada. The accounts receivable exposures result from BPA providing a wide variety of power products and transmission services. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. During fiscal years 2006, 2005, and 2004, BPA experienced no significant losses as a result of any customer defaults or bankruptcy filings.

Credit risk is mitigated at BPA by reviewing counterparties for creditworthiness, establishing credit limits, and monitoring credit exposure on a daily basis, and performing Credit Value at Risk (CVaR) measurements for forward power transactions on a weekly basis. In order to further manage credit risk, BPA obtains credit support such as letters of credit and third-party guarantees from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly.

Allowance for Doubtful Accounts

Management reviews accounts receivable on a monthly basis to determine if any receivable will potentially be uncollectible. The allowance for doubtful accounts includes amounts estimated through an evaluation of specific accounts, based upon the best available facts and circumstances, of customers that may be unable to meet their financial obligations, and a reserve for all other customers based on historical experience.

The largest risk relates to the California power markets which were in turmoil during 2000 to 2001 and experienced historically high power prices and volatility along with the continued uncertainty related to deregulation. The California Independent System Operator and California Power Exchange, two customers with whom BPA had contracts for power and transmission delivery during that period, have been unable to fully pay BPA for their purchases. BPA has recorded an allowance for doubtful accounts which in management's best estimate are sufficient to cover potential exposure. Net exposure after the allowance is not significant. BPA has continued to pursue collection of amounts due.

Post-Retirement Benefits

Federal employees associated with the operation of the FCRPS, are participants in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Both federal employers and their employees contribute a percentage of eligible employee compensation toward funding these post-retirement benefit plans. Based on the statutory contribution rates, retirement benefit expense under CSRS is equivalent to 7 percent of eligible employee compensation and under FERS is equivalent to 11.2 percent of eligible employee compensation. However, the legislatively mandated contribution levels do not fully cover the cost to the federal government to provide the plan benefits. Therefore, the programs are considered underfunded. Employees also may be participants in the Federal Employees Health Benefits Program (FEHB) and/or the Federal Employees' Group Life Insurance Program (FEGLI); these plans are similarly underfunded. Retirement benefits under the federal retirement systems are payable by the U.S. Treasury.

In order to ensure that all post-retirement benefit programs provided to its federal employees are fully funded and such costs are both recovered through rates and properly expensed, BPA makes additional annual contributions to the U.S. Treasury. The deferred amount of prior year commitments for underfunded post retirement benefits has been recorded as a regulatory asset. BPA has a $2.6 million remaining liability as of Sept. 30, 2006, which is included in other current liabilities and deferred credits in the accompanying Combined Balance Sheet representing the balance of deferred additional contributions from fiscal years 1998 through 2001. The liability is reduced as prior years' additional contributions are made. BPA expects to satisfy its prior year commitments for underfunded post-retirement benefits by fiscal year 2007.

SFAS 133 Derivative Mark-to-Market

BPA follows the provisions of SFAS 133, "Accounting for Derivative Instrument and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 133 requires that every derivative instrument be recorded on the balance sheet as an asset or liability measured at its fair value and that change in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met.

It is BPA's policy to document and apply as appropriate the normal purchase and normal sales exception under SFAS 133. Purchases and sales of forward electricity that require physical delivery and which are expected to be used or sold by BPA in the normal course of business are generally considered normal purchases and normal sales under SFAS 133. These transactions are not required to be recorded at fair value in the financial statements. For all other derivative transactions, BPA applies fair value accounting and records the amounts in the current period Combined Statement of Revenues and Expenses. BPA does not apply hedge accounting.

BPA recorded a SFAS 133 mark-to-market unrealized (loss) gain in the Combined Statements of Revenues and Expenses related to its derivative portfolio (including physical power purchase and sale transactions, power exchange transactions, and interest rate swap transactions) of $(100.1) million, $94.6 million and $89.4 million for fiscal years 2006, 2005, and 2004, respectively.

Interest Rate Swap Transactions

BPA has entered into two floating-to-fixed LIBOR interest rate swaps to help manage interest rate risk related to its long-term debt portfolio. In the first swap transaction, BPA pays a fixed 3.1 percent on $300 million notional amount for 10 years and receives a variable rate that changes weekly tied to LIBOR. This swap transaction terminates in 2013.

In the second swap transaction, BPA pays a fixed 3.5 percent on $200 million notional amount for 15 years and receives a variable rate that changes weekly tied to LIBOR. This swap transaction terminates in 2018. The floating interest rates on the swaps are reset on a weekly basis. The net effect of the two swap transactions is essentially replacing variable rate debt with 3.3 percent fixed rate debt. The swap transactions do not qualify for hedge accounting treatment under SFAS 133. BPA recorded a $8.4 million unrealized fair value gain, $4.3 million unrealized fair value gain and a $2.1 million unrealized fair value gain in the Combined Statements of Revenues and Expenses for fiscal years 2006, 2005, and 2004 respectively, related to the interest rate swap transactions.

Revenues and Net Revenues

Operating revenues are recorded when services are rendered and include estimated unbilled revenues of $247 million, $209 million and $158 million at Sept. 30, 2006, 2005, and 2004, respectively. BPA operates as two segments: the Power Business Line and the Transmission Business Line. In Note 8 Segments, the table reflects revenues and expenses attributable to each business line. Because BPA is a U.S. government power marketing administration, net revenues over time are committed to repayment of the U.S. government investment in the FCRPS and the payment of certain irrigation costs as discussed in Note 7 Commitments and Contingencies.

U.S. Treasury Credits for Fish

The Northwest Power Act of 1980 obligates the BPA administrator to make expenditures for fish and wildlife protection, mitigation and enhancement for both power and non-power purposes, on a reimbursement basis. The Northwest Power Act also specifies that consumers of electric power, through their rates for power services "shall bear the costs of measures designed to deal with adverse impacts caused by the development and operation of electric power facilities and programs only." Section 4(h)(10)(C) of the Northwest Power Act was designed to ensure that the costs of mitigating these impacts are properly accounted for among the various purposes of the hydroelectric projects. In the early 1990s, BPA, the U.S. Treasury and the Office of Management and Budget agreed to a crediting mechanism whereby BPA reduces its cash payments to the U.S. Treasury by an amount equal to the mitigation measures funded on behalf of the non-power purposes. BPA has taken U.S. Treasury credits for fish annually since 1995.

Recent Accounting Pronouncements

In March 2005, the FASB issued FASB Interpretation (FIN) 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement 143." FIN 47 clarifies that an entity is required to recognize a liability for a legal obligation to perform an asset retirement activity if the fair value can be reasonably estimated even though the timing and (or) method of settlement are conditional on a future event. This interpretation is effective for BPA for the financial statements issued for fiscal year 2006.

In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections," which replaces Accounting Principles Board (APB) Opinion 20, "Accounting Changes," and SFAS 3, "Reporting Accounting Changes in Interim Financial Statements." SFAS 154 applies to all voluntary changes in accounting principles and also applies to changes required by an accounting pronouncement that do not include specific transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after Dec. 15, 2005. Adoption of this new standard in fiscal year 2007 is not expected to have a material impact on BPA's financial condition, results of operations or cash flows.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for BPA in fiscal year 2009. BPA is currently evaluating the impact, if any, of the provisions of SFAS 157.

In September 2006, the FASB issued SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Post-Retirement Plans." SFAS 158 requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other post-retirement plans in their financial statements. The provisions of SFAS 158 are effective for BPA in fiscal year 2007. BPA is currently evaluating the impact, if any, of the provisions of SFAS 158.

2. Other Assets

Regulatory Assets

As of Sept. 30 — thousands of dollars

	2006	2005
Federal:		
IOU exchange benefits	$1,206,539	$ 963,539
Columbia River fish mitigation	330,244	—
Conservation measures	271,934	298,189
Direct-service industries benefits	177,000	—
Fish and wildlife measures	128,906	113,776
Settlements	54,423	51,592
Federal Employee Compensation Act	33,388	33,158
Capital bond premiums	19,011	22,632
Other	10,784	6,600
Nonfederal:		
Terminated nuclear facilities	3,897,275	3,917,450
Sponsored conservation	36,847	40,264
Terminated hydro facilities	26,485	27,305
Nuclear decommissioning	24,876	35,091
	$6,217,712	$5,509,596

BPA defers costs as regulatory assets in connection with the rate-setting process as described in Note 1 Summary of Significant Accounting Policies.

IOU exchange benefits reflect costs that will be recovered through rates as discussed in Note 6 Other Liabilities.

Columbia River fish mitigation is the cost of research and development for fish bypass facilities funded through appropriations since 1989 in accordance with the Energy and Water Development Appropriations Act, 1989 (Public Law 100-371). These costs will be recovered through future rates and amortized as scheduled.

Conservation measures consist of the costs of capitalized conservation measures and are amortized over periods up to 20 years.

Costs associated with direct-service industries benefits described in Note 6 Other Liabilities, will be recovered in rates during the periods in which the costs will be paid in fiscal years 2007 through 2011.

Fish and wildlife consist of the costs of capitalized fish and wildlife projects and are amortized over a period of 15 years.

Settlements reflect costs related to contractual settlement agreements or proposed settlements stemming from litigation where BPA will recover costs over the life of the contracts.

Federal Employees Compensation Act (FECA) reflects the estimated amount of future payments for current recipients of FCRPS workers' compensation benefits.

Capital bond premiums are the deferred losses related to refinanced debt which are amortized over the life of the new debt instruments.

Costs associated with nonfederal regulatory assets will be recovered through rates during the periods in which the costs are scheduled to be repaid.

Terminated nuclear facilities include the nonfederal debt for Energy Northwest Nuclear Project Nos. 1 and 3 and 30 percent of the Trojan project. See Note 5 Nonfederal Projects and Related Debt.

Sponsored conservation consists of the nonfederal debt for Emerald People's Utility District loans, Conservation and Renewable Energy System and City of Tacoma Conservation bonds, all issued to finance conservation programs sponsored by BPA.

Terminated hydro facilities include the nonfederal debt for the terminated Northern Wasco hydro project.

Nuclear decommissioning costs reflect the remaining costs to be recovered for fully funding the related AROs net of the amounts previously recovered and held in trust. See Note 6 Other Liabilities for a complete discussion of the nonfederal nuclear AROs.

Deferred Charges and Other

As of Sept. 30 — thousands of dollars

	2006	2005
SFAS 133 derivative mark-to-market	$ 57,113	$ 175,591
NIFC funds in trust	21,581	26,731
Energy receivable	13,801	18,980
Other	8,529	13,471
	$101,024	$ 234,773

SFAS 133 derivative mark-to-market represents unrealized fair value gains of derivative contracts. NIFC funds in trust are amounts remaining from construction of the Schultz-Wautoma transmission line. The funds are held by a trustee to pay the project's costs. Energy receivable is energy to be returned to BPA for prior transmission line losses. Other is primarily Corps and Reclamation costs for generating assets not placed in service.

3. Federal Appropriations

Federal Appropriations

As of Sept. 30 — thousands of dollars

	Term Repayments
2007	$ 33,694
2008	10,913
2009	9,889
2010	26,327
2011	21,232
2012 and thereafter	4,221,674
	$4,323,729

Includes payments on historic replacements but excludes planned future replacements and irrigation assistance.

The weighted average interest rate was 6.7 percent on outstanding appropriations as of Sept. 30, 2006.

Prior to the mid-1990s, construction and replacement of Corps and Reclamation generating facilities were financed through federal appropriations to the Corps and Reclamation. Annual appropriations were also made for operation and maintenance costs, to be repaid by BPA to the U.S. Treasury by the end of each fiscal year. As a result of the Energy Policy Act of 1992, BPA directly funds most operation and maintenance expenses and capital efficiency and reliability improvements for Corps and Reclamation generating facilities.

Federal generation and transmission appropriations are repaid to the U.S. Treasury within the weighted average service lives of the associated investments (maximum 50 years) from the time each facility is placed in service.

If, in any given year, revenues are not sufficient to cover all cash needs, including interest, any deficiency becomes an unpaid annual expense. Interest is accrued on the unpaid annual expense until paid. This interest must be paid from subsequent years' revenues before any repayment of federal appropriations can be made.

4. Bonds Issued to U.S. Treasury

The table on the following page reflects the terms and amounts of bonds issued to U.S. Treasury.

To finance its capital programs, BPA is authorized by Congress to issue to the U.S. Treasury up to $4.45 billion of interest-bearing debt with terms and conditions comparable to debt issued by U.S. government corporations. Of the $4.45 billion, $1.25 billion is reserved for conservation and renewable resource loans and grants. At Sept. 30, 2006, of the total $2.48 billion of outstanding bonds, $764.8 million were conservation and renewable resource loans and grants (including Corps, Reclamation and U.S. Fish and Wildlife Service capital investments). The average interest rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently. As a result, the fair value of BPA bonds issued to U.S. Treasury, based upon discounting future cash flows using rates offered by the U.S. Treasury as of Sept. 30, 2006, for similar maturities, exceeds carrying value by approximately $132 million, or 5.3 percent.

Bonds Issued to U.S. Treasury

Long-term debt — thousands of dollars

	First call date	Maturity date	Interest rate	Amount
December 2002	none	2006	3.05%	$ 40,000
January 2004	none	2007	2.50%	60,000
January 2004	none	2007	2.50%	25,000
April 2003	none	2007	2.90%	40,000
April 2004	none	2007	2.95%	65,000
April 2004	none	2007	2.95%	35,000
July 2003	none	2007	2.95%	25,000
July 2004	none	2007	3.45%	50,000
July 2004	none	2007	3.45%	25,000
August 1997	none	2007	6.65%	111,300
September 2003	none	2007	3.10%	20,000
September 2004	none	2007	3.10%	30,000
September 2004	none	2007	3.10%	30,000
November 2004	none	2007	3.50%	20,000
January 2004	none	2008	2.95%	65,000
January 2004	none	2008	2.95%	30,000
January 2005	none	2008	3.60%	20,000
April 1998	none	2008	6.00%	75,300
April 1998	none	2008	6.00%	25,000
June 2005	none	2008	3.95%	30,000
July 2004	none	2008	3.80%	25,000
August 1998	none	2008	5.75%	40,000
September 1998	none	2008	5.30%	104,300
September 2005	none	2008	4.25%	25,000
September 2005	none	2008	4.25%	20,000
November 2004	none	2008	3.75%	35,000
March 2006	none	2009	5.05%	20,000
March 2006	none	2009	5.05%	20,000
March 2006	none	2009	5.05%	20,000
March 2006	none	2009	5.05%	25,000
May 1998	none	2009	6.00%	72,700
May 1998	none	2009	6.00%	37,700
June 2005	none	2009	4.00%	40,000
July 1989	none	2009	8.55%	40,000
July 2006	none	2009	5.35%	70,000
July 2006	none	2009	5.35%	45,000
September 2006	none	2009	4.95%	15,000
January 2001	none	2010	6.05%	60,000
January 2001	none	2010	6.05%	30,000
September 2006	none	2010	4.95%	20,000
September 2006	none	2010	4.95%	15,000
September 2006	none	2010	4.95%	20,000
May 1998	none	2011	6.20%	40,000
June 2001	none	2011	5.95%	25,000
August 2001	none	2011	5.75%	50,000
January 1998	none	2013	6.10%	60,000
September 1998	none	2013	5.60%	52,800
February 1999	none	2014	5.90%	60,000
April 1998	2008	2028	6.65%	50,000
August 1998	none	2028	5.85%	106,500
August 1998	none	2028	5.85%	112,300
May 1998	2008	2032	6.70%	98,900
April 2003	2008	2033	5.55%	40,000
September 2004	2009	2034	5.60%	40,000
January 2005	2010	2035	5.40%	40,000
April 2005	2010	2035	5.50%	40,000
September 2005	2010	2035	5.25%	45,000
				$2,481,800
Less current portion				(556,300)
				$1,925,500

All construction, conservation, fish and wildlife, and Corps/Reclamation direct funding bonds are term bonds.

The weighted average interest rate was 5.1 percent on outstanding bonds issued to U.S. Treasury as of Sept. 30, 2006.

5. Nonfederal Projects and Related Debt

Nonfederal Projects and Related Debt

As of Sept. 30 — thousands of dollars

Principal Payments	
2007	$ 230,879
2008	288,758
2009	281,244
2010	287,313
2011	282,674
2012 and thereafter	5,144,390
	$ 6,515,258

The weighted average interest rate was 5.4 percent on the major portion of outstanding nonfederal projects debt as of Sept. 30, 2006.

In addition to the CGS nuclear generating project, BPA has also acquired all or part of the generating capability of four other nuclear projects which are not providing power. These other projects are Energy Northwest Nuclear Project No. 1 (Project 1), Nuclear Project No. 3 (Project 3), 72 percent of the Hanford Generating Plant, and 30 percent of the Trojan project owned by Eugene Water and Electric Board (EWEB), Portland General Electric and PacifiCorp. The contracts to acquire the generating capability of the non-operating nuclear projects require BPA to pay all or part of the annual projects' budgets, including maintenance expense and debt service. Project 1 and Project 3 were terminated prior to completion. Hanford and Trojan were decommissioned.

Along with the Cowlitz Falls hydro generating project, BPA has acquired all of the generating capability of Northern Wasco hydro project and agreed to pay the maintenance expense and debt service. However, the project was terminated prior to completion.

BPA has agreed to fund debt service on Emerald People's Utility District loans, Conservation and Renewable Energy System and City of Tacoma Conservation bonds, all issued to finance conservation programs sponsored by BPA.

Operating projects are included in nonfederal generation and non-operating projects are included in regulatory assets. See Note 1 Summary of Significant Accounting Policies. The debt for both the operating and non-operating nonfederal projects is included in nonfederal projects debt. BPA recognizes expenses for these projects based upon total project cash funding requirements.

Operating and maintenance expense for the projects of $243 million, $257 million, and $235 million in fiscal years 2006, 2005, and 2004, respectively, is included in operations and maintenance in the accompanying Combined Statements of Revenues and Expenses. Debt service for the projects of $338 million, $292 million, and $248 million for fiscal years 2006, 2005, and 2004, respectively, is reflected as nonfederal projects expense in the accompanying Combined Statements of Revenues and Expenses.

The fair value of all Energy Northwest debt exceeds recorded value by $349 million, or 5.6 percent based on discounting the future cash flows using interest rates for which similar debt could be issued at Sept. 30, 2006. All other nonfederal projects' debt approximates fair value as stated.

In November 2005, BPA completed construction of the Schultz-Wautoma transmission line. The line allows BPA to continue to transmit reliable, low cost power to ratepayers throughout the Pacific Northwest. Construction of the line began in April 2003 and it was energized in December 2005. The line was financed by NIFC through a taxable bond issuance totaling $119.6 million. NIFC owns the line and leases it to BPA for a period of 30 years. At the expiration of the lease, BPA can purchase the line for a bargain purchase price. NIFC has been consolidated into the BPA financial statements since NIFC's inception under FIN 46 and the bonds are included as nonfederal debt on the FCRPS statements.

6. Other Liabilities

Regulatory Liabilities

As of Sept. 30 — thousands of dollars

	2006	2005
Capitalization adjustment	$1,926,321	$ 1,991,226
Accumulated plant removal costs	132,179	119,454
Other	13,862	18,980
	$2,072,362	$2,129,660

BPA defers credits as regulatory liabilities in connection with the rate-setting process as described in Note 1 Summary of Significant Accounting Policies.

The BPA Appropriations Refinancing Act (Refinancing Act), 16 U.S.C. 838(l), required that the outstanding balance of the FCRPS federal appropriations, which BPA is obligated to set rates to recover, be reset and assigned prevailing market rates of interest as of Sept. 30, 1996. The resulting principal amount of appropriations was determined to be equal to the present value of the principal and interest that would have been paid to the U.S. Treasury in the absence of the Refinancing Act, plus $100 million. The $100 million was capitalized as part of the appropriations balance and was included pro rata in the new principal of the individual appropriated repayment obligations. The amount of appropriations refinanced was $6.6 billion. After refinancing, the appropriations outstanding were $4.1 billion. The difference between the appropriated debt before and after the refinancing was recorded as a capitalization adjustment in regulatory liabilities. This adjustment is being amortized over the remaining period of repayment so that total FCRPS net interest expense is equal to what it would have been in the absence of the Refinancing Act. Amortization of the capitalization adjustment was $64.9 million, $64.9 million and $68.6 million for fiscal years 2006, 2005, and 2004, respectively.

Accumulated plant removal costs is the amount previously collected through rates in excess of amounts expended.

Other is the amount collected through billing settlements which reduces future rates.

IOU Exchange Benefits

As provided for in the Northwest Power Act, beginning in 1982 BPA entered into residential exchange contracts with most of its electric utility customers. These contracts resulted in payments to the utilities if a utility's average system cost exceeded BPA's priority firm (PF) rate on the "exchanged" power. These payments were required to be passed through to the utilities' qualified residential and small-farm customers.

Subsequently, contract termination agreements were signed by all actively exchanging Pacific Northwest utilities except Northwestern Energy (formerly the Montana Power Co.), which had not been receiving benefits. BPA made payments to settle the utilities' and BPA's rights and obligations under the residential exchange program through June 30, 2001, and in some cases, through June 30, 2011.

In October 2000, BPA's investor-owned utility (IOU) customers signed subscription settlement agreements, under which BPA was to provide monetary and power benefits in place of residential exchange benefits for the period July 1, 2001, through Sept. 30, 2011. These agreements provided for both sales of power and monetary benefit payments to the IOUs and also allowed the power to be converted to cash payments.

Amendments to the October 2000 contracts allowed payment of a portion of the fiscal year 2003 IOU Subscription settlement benefits to be deferred and paid in the fiscal year 2007 through 2011 period.

In May 2004, BPA signed new contracts and amendments with all six IOU customers entitled "Agreements Regarding Payment of Residential Exchange Program Settlement Benefits During Fiscal Years 2007-2011." These agreements established a method for calculating the IOUs' monetary benefits for the fiscal years 2007 through 2011 period including an annual floor of $100 million and an annual cap of $300 million for the six IOUs in total, and all parties agreed that BPA would have no obligation to provide power to the IOUs during that period. These agreements also eliminated $100 million of a $200 million risk contingency payment owed to two IOUs that have load reduction payments, and deferred the remaining $100 million payment and related interest to the fiscal years 2007 through 2011 period.

As of Sept. 30, 2006, IOU exchange benefit amounts for fiscal years 2007 through 2009 have been recorded at the cap amount of $300 million per year since those amounts are considered probable based on the Forward Flat-Block Price Forecast (FBPF) determined under the settlement contract provisions and firm rates in place for that period. Under the contract, the monetary benefits are calculated as the difference between the FBPF and the lowest PF rate. IOU exchange benefits for 2010 and 2011 cannot be reasonably estimated until the 2010-2011 rate case process begins. In accordance with the contract, the benefits for 2010 and 2011 will be calculated when the FBPF forecasts become available. Therefore, the annual floor of $100 million has been recorded for 2010 and 2011.

At Sept. 30, 2005, the rates for fiscal years 2007 through 2009 had not been proposed and, as such, reasonable estimates could not be made of the probable costs of the obligations for those years. Accordingly, the liability was recorded at the floor amounts.

In addition, the IOU risk contingency payment amounts that were deferred in fiscal year 2004 will be repaid $20 million per year (plus interest) during the fiscal year 2007 through 2011 period and have been recorded as a liability at both Sept. 30, 2006 and 2005. The IOU exchange benefits recorded on the Combined Balance Sheet at Sept. 30, 2005 also includes the $357 million obligation for 2006 that was paid in fiscal year 2006. The amounts to be collected through future rates are included in regulatory assets.

Further, it is possible that these agreements may be revised in connection with legal challenges that have been filed with the Ninth Circuit Court, which could result in a remand and potential changes to the IOU exchange benefit amounts to be provided to the IOU customers. BPA believes it is likely that the agreements will be sustained.

AROs Activity

For the years ended Sept. 30 — thousands of dollars

	2006	2005	2004
Beginning Balance	$160,600	$164,000	$126,000
Activities:			
Additions	3,500	—	—
Expenditures	(2,000)	(7,800)	(7,900)
Accretion	7,400	7,700	6,800
Revisions	(200)	(3,300)	39,100
Ending Balance	$169,300	$160,600	$164,000

The AROs for CGS decommissioning and site restoration, Project Nos. 1 and 4 site restoration, Trojan decommissioning, and BPA's PCBs, asbestos, and wood poles are $169.3 million and $160.6 million at Sept. 30, 2006 and 2005, respectively. BPA has recorded estimated liabilities on a fair value basis of $103.3 million for CGS decommissioning and site restoration, $49.1 million for Trojan decommissioning, $13.4 million for Project Nos. 1 and 4 site restoration, and $3.5 million for BPA's PCBs, asbestos, and wood poles.

In fiscal year 2006, additions of $3.5 million were recognized for transition adjustments resulting from the application of FIN 47, consisting of the environmental costs associated with PCBs, asbestos and wood poles that occur during the retirement of transmission assets.

Decommissioning costs for CGS are charged to operations over the operating life of the project. An external trust fund for decommissioning costs is being funded monthly for CGS. The trust funds are expected to provide for decommissioning at the end of the project's safe storage period in accordance with Nuclear Regulatory Commission (NRC) requirements. The NRC requires that this period be no longer than 60 years. Trust fund requirements for CGS are based on a NRC decommissioning cost estimate and assume a 60-year operating life.

BPA has funded $140.9 million for the nonfederal AROs, which is held in trusts and recorded in the Combined Balance Sheet at Sept. 30, 2006. The trust fund balances are $106.3 million and $34.6 million for decommissioning and site restoration, respectively at Sept. 30, 2006. Payments to the trusts for fiscal years 2006, 2005, and 2004 were approximately $6.2 million, $5.5 million, and $5.0 million, respectively. The funds are invested in cash equivalents, equity, and fixed income funds. The cash equivalents and fixed income funds are valued at cost and the equity funds are valued at market. The unfunded amount will be collected in future rates and is included in regulatory assets in the Combined Balance Sheets. BPA directly funds EWEB's 30 percent share of Trojan's decommissioning costs through current rates. Decommissioning costs are included in operations and maintenance expense in the accompanying Combined Statements of Revenues and Expenses.

Deferred Credits

Deferred credits include the various long-term liabilities and unearned revenues described below.

Customer reimbursable projects consist of advances received from customers where either the customer or BPA will own the resulting asset. If the customer will own the asset under construction, the revenue is recognized as the expenditures are incurred. If BPA will own the resulting asset, revenue is recognized over the life of the asset, once the corresponding asset is placed in service.

Direct-service industries (DSI) benefits reflect a contractual liability to three Northwest aluminum companies and one paper mill for fiscal years 2007 through 2011. The contracts became effective on Oct. 1, 2006 and continue in effect through Sept. 30, 2011.

Third AC intertie capacity agreements reflect unearned revenues from customers related to the Third AC intertie capacity project. Revenue is being recognized over an estimated 49 year life of the related assets.

Fiber optic leasing fees reflect unearned revenue related to the leasing of the fiber optic cable. Revenue is being recognized over the lease terms extending out to 2020.

Deferred Credits

As of Sept. 30 — thousands of dollars

	2006	2005
Customer reimbursable projects	$ 205,238	$ 158,469
DSI benefits	177,000	—
Third AC intertie capacity agreements	113,416	116,481
Fiber optic leasing fees	49,951	55,444
Large generation interconnection agreements	46,714	18,950
Settlements	38,500	50,810
Federal Employee Compensation Act	33,388	33,158
Capital leases	19,454	19,854
Other	12,184	28,918
	$ 695,845	$ 482,084

Large generation interconnection agreements are generators' funds held as security for requested new network upgrades and interconnection. These funds accrue interest and will be returned as credits against future transmission service on the new or upgraded lines.

Settlements reflect payments due customers or counterparties as a result of contractual settlement agreements and proposed settlements stemming from litigation. See Note 7 Commitments and Contingencies.

Federal Employees Compensation Act (FECA) is an actuarial estimate which represents the expected amount of future payments for current recipients of BPA workers' compensation benefits.

Capital leases represent the long-term portion of capital lease liabilities for two transmission lines.

7. Commitments and Contingencies

Purchase Power and Sale Commitments

As of Sept. 30 — thousands of dollars

	Purchases	Sales
2007	$109,835	$1,960,097
2008	60,306	1,948,025
2009	61,444	1,953,766
2010	33,616	1,996,838
2011	33,597	2,004,287
	$298,798	$9,863,013

Subscription contracts are the basis for the contractual relationship between BPA and its preference customers. These contracts expire by Sept. 30, 2011. BPA enters into sale commitments to sell expected surplus generating capabilities at future dates and purchase commitments to purchase power at future dates when BPA forecasts a shortage of generating capability and prices are favorable. Further, BPA enters into these contracts throughout the year to maximize its revenues on estimated surplus volumes. BPA records these sales and purchases in the month the underlying power is delivered.

Irrigation Assistance

As of Sept. 30 — thousands of dollars

	Scheduled Distributions
2007	$ —
2008	2,950
2009	7,211
2010	—
2011	—
2012 and thereafter	671,349
	$681,510

Excludes $40.3 million for Lower Teton, which was never completed, therefore never produced electricity and the administrator has no obligation to recover these costs.

As directed by legislation, BPA is required to make cash distributions to the U.S. Treasury for original construction costs of certain Pacific Northwest irrigation projects that have been determined to be beyond the irrigators' ability to pay. These irrigation distributions do not specifically relate to power generation and are required only if doing so does not result in an increase to power rates. Accordingly, these distributions are not considered to be regular operating costs of the power program and are treated as distributions from accumulated net revenues (expenses) when paid. BPA paid irrigation assistance payments of $739 thousand in fiscal year 2004. Future irrigation assistance payments ultimately could total $682 million and are scheduled over a maximum of 66 years. BPA is required by Public Law 89-448 to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA net revenues within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects, which are beyond the ability of the 22 irrigation water users to repay. These requirements are met by conducting power repayment studies including schedules of distributions at the proposed rates to demonstrate repayment of principal within the allowable repayment period.

Additional Post-Retirement Contributions

As of Sept. 30 — thousands of dollars

	Estimated Contributions
2007*	$ 21,100
2008*	18,000
2009	30,554
2010	31,195
2011	32,142
	$ 132,991

* Currently scheduled.

BPA makes additional annual contributions to the U.S. Treasury in order to ensure that all federal post-retirement benefit programs provided to federal employees associated with the operation of the FCRPS are fully funded and such costs are both recovered through rates and properly expensed. The additional contributions are based on employee plan participation and the extent to which the particular plans are underfunded. BPA paid $23.2 million, $26.5 million, and $30.9 million to the U.S. Treasury during fiscal years 2006, 2005, and 2004, respectively. These amounts were recorded as expense when paid.

Net-Billing Agreements

BPA has agreed with Energy Northwest that in the event any participant shall be unable for any reason, or shall refuse, to pay to Energy Northwest any amount due from such participant under its net-billing agreement for which a net-billing credit or cash payment to such participant has been provided by BPA, BPA will be obligated to pay the unpaid amount in cash directly to Energy Northwest, unless payment of such unpaid amount is made in a timely manner pursuant to the net-billing agreements.

Nuclear Insurance

BPA is a member of the Nuclear Electric Insurance Limited (NEIL), a mutual insurance company established to provide insurance coverage for nuclear power plants. The types of insurance coverage purchased from NEIL by BPA include: 1) Primary Property and Decontamination Liability Insurance; 2) Decommissioning Liability and Excess Property Insurance; and 3) Business Interruption and/or Extra Expense Insurance.

Under each insurance policy BPA could be subject to an assessment in the event that a member-insured loss exceeds reinsurance and reserves held by NEIL. The maximum assessment for the Primary Property and Decontamination Insurance policy is $7.4 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is $15.9 million. For the Business Interruption and/or Extra Expense Insurance policy, the maximum assessment is $5.0 million.

As a separate requirement, BPA is liable under the Nuclear Regulatory Commission's indemnity for public liability coverage under the Price-Anderson Act. In the event of a nuclear accident resulting in public liability losses exceeding $300 million, BPA could be subject to a retrospective assessment of up to $95.8 million limited to an annual maximum of $10 million. Assessments would be included in BPA's costs and recovered through rates.

Environmental Matters

From time to time, there are sites for which BPA, Corps, or Reclamation has been or may be identified as a potential responsible party. Costs associated with cleanup of those sites are not expected to be material to the FCRPS' financial statements and would be recoverable through rates.

Litigation

Slice

On Nov. 17, 2003, BPA's Slice Customers filed a petition with the Ninth Circuit Court challenging BPA's final determinations under the Slice Agreements of a Slice true-up adjustment charge, which is an annual adjustment to the Slice Rate. The Slice Customers assert that BPA's Slice true-up adjustment charge for contract year 2002 is inconsistent with the terms of the Slice contracts and resulted in $84 million in overcharges. The Slice Customers further assert that the court lacks jurisdiction to resolve the dispute because the Slice contracts require binding arbitration for such disputes. On Oct. 23, 2003, a group of BPA's full requirements preference customers, represented by the Northwest Requirements Utilities (NRU), filed a petition in the Ninth Circuit Court challenging the same Slice true-up adjustment charge. NRU challenges different aspects of BPA's Slice true-up adjustment charge than the Slice Customers and are concerned that if the Slice Customers prevail, the result would be a cost shift to NRU members of up to $84 million. The cases were consolidated (NRU I), and have been fully briefed and argued.

On March 16, 2004, NRU filed an additional petition for review (NRU II) challenging BPA's 2003 Slice true-up adjustment charge. The Slice Customers intervened in NRU II, and have alleged BPA's 2003 Slice true-up adjustment overcharged them by $80 million. NRU II has been stayed ever since it was filed.

Throughout the litigation, the parties had been involved in extensive settlement discussions. The settlement discussions have culminated in a proposed Settlement Agreement. NRU I and NRU II are both stayed through mid-

November 2006 while the Settlement Agreement is being circulated among the parties for final review, approval, and execution.

Residential Exchange Program

In connection with the implementation of post-2001 power sales agreements, BPA prepared draft Residential Purchase and Sale Agreements (RPSAs) and tendered the form of such agreements to the regional IOUs for their consideration and possible execution. The draft RPSAs proposed to define BPA's statutory obligations under the Residential Exchange Program provisions of the Northwest Power Act for the ten year period beginning Oct. 1, 2001. During the same time-frame, BPA negotiated certain agreements (Residential Exchange Settlement Agreements) with regional IOUs to settle BPA's statutory Residential Exchange Program obligation under such agreements in lieu of the RPSAs for the five and/or ten year period beginning Oct. 1, 2001. In October 2000, all six regional IOUs entered into the Residential Exchange Settlement Agreements in lieu of the RPSAs.

A number of BPA's customers and customer groups filed petitions with the Ninth Circuit Court seeking review of the RPSAs and the Residential Exchange Settlement Agreements and the related records of decisions prepared by BPA. A number of interventions have also been filed in the foregoing challenges. Among those participating in the litigation are a group of DSIs, all six regional IOUs and a number of preference customers and preference customer groups.

The challenges to BPA's final actions with regard to the RPSAs and the Residential Exchange Settlement Agreements allege generally that the RPSAs and Residential Exchange Settlement Agreements violate the Bonneville Project Act, the Pacific Northwest Consumer Power Preference Act, the Transmission System Act, the Northwest Power Act, NEPA, and/or the Administrative Procedure Act. In the event the court would grant the petitions, BPA expects the likely remedies would be that the Residential Exchange Settlement Agreements, and/or RPSAs, be remanded to BPA for redevelopment or that Regional IOUs be allowed only to participate in the Residential Exchange Program under the RPSAs.

On Nov. 14, 2005, oral argument was held before the Ninth Circuit Court, and at the court's request supplemental briefs were filed in January 2006. The parties await the court's decision.

Southern California Edison v. Bonneville Power Administration

Southern California Edison (SCE) has three separate actions pending in the U.S. Court of Federal Claims against BPA related to a power sales agreement (Sale and Exchange Agreement) between BPA and SCE.

The actions challenge 1) BPA's decision to convert the contract from a sale of power to an exchange of power as provided for under the terms of the contract (Conversion Claim); 2) BPA's adjustment of the FPS-96 rate schedule to establish a posted rate for a capacity product SCE may purchase as part of an option feature of the Sale and Exchange Agreement, which adjustment SCE alleges violates its power sales contract (Rate Adjustment Claim); and 3) BPA's termination of its performance under the contract due to SCE's non-performance (Termination Claim).

With respect to the Conversion Claim, SCE's complaint seeks damages in the amount of approximately $186 million. BPA filed a motion to dismiss for failure to state a claim for which relief can be granted. On Oct. 24, 2003 the motion was denied. The court has stayed discovery pending the outcome of settlement discussions. With respect to the Rate Adjustment Claim, SCE's complaint seeks damages in the amount of $32 million. In November 2004, BPA filed a motion to dismiss the complaint for lack of subject matter jurisdiction. On Nov. 10, 2005, this motion was denied. BPA filed an answer to SCE's complaint and the claim will now be tried on the merits. The court has set a trial date for Dec. 4, 2006. With respect to the Termination Claim, SCE's complaint seeks damages of $22 million. BPA filed a motion to dismiss for lack of subject matter jurisdiction. The court has preliminarily dismissed BPA's motion pending the outcome of settlement discussions. In the event the claim is not settled, the court will reinstate BPA's motion.

On June 5, 2006, BPA and SCE executed an agreement to settle the Conversion Claim and the Termination Claim, whereby BPA would make a settlement payment to SCE in exchange for SCE dismissing the two claims. As provided in the settlement, SCE and BPA have filed a joint motion with the court to stay the proceeding pending final resolution.

The settlement identifies three conditions precedent to final resolution: (a) SCE must obtain approval of the settlement from the California Public Utilities Commission (CPUC); (b) BPA must complete a public review and comment process and subsequently reaffirm the settlement; and (c) BPA must receive a final resolution of its refund liability, if any, in the California refund proceedings. SCE filed the proposed settlement with the CPUC on July 5, 2006, but the CPUC has taken no action to date. BPA has completed its public review process, and reaffirmed the proposed settlement on Aug. 2, 2006. When and if the remaining conditions are met, the settlement agreement further provides that BPA will pay SCE $28.5 million, plus interest accruing from the date the settlement was signed until the date of payment. Upon payment, SCE and BPA would file a joint motion with the court to dismiss the two claims. Since BPA management believes the ultimate settlement of these two claims will be upheld in accordance with the settlement, a liability of $28.5 million is included in the Combined Balance Sheet at Sept. 30, 2006. The settlement does not resolve the Rate Adjustment Claim and, based on the uncertainties with the claim, a liability has not been recorded.

DSI Service Record of Decision

On June 30, 2005, BPA issued a record of decision entitled "Bonneville Power Administration's Service to the Direct Service Industrial Customers for Fiscal Years 2007-2011" (DSI ROD). The DSI ROD established a policy framework which BPA subsequently used to develop new DSI power sales contracts for the FY 2007-2011 period.

On Sept. 28, 2005, Alcoa, Inc., (Alcoa), a BPA direct service industrial customer, filed a petition for review in the Ninth Circuit Court challenging the DSI ROD. On the same day, the Pacific Northwest Generating Cooperative (PNGC), a consortium of BPA public preference customers, filed a separate petition for review. Although Alcoa's legal theory is unknown at this time, PNGC has contended in other litigation that BPA lacks statutory authority to provide service benefits to the DSIs at the expense of its public preference customers. In August 2006, Alcoa and PNGC filed additional petitions related to BPA's decisions for service to the DSI's in FY 2007-2011. These additional petitions challenge BPA's Supplement to the DSI ROD, issued on May 31, 2006, and the power sales contracts executed by and between BPA and the DSIs in June 2006. Motions to consolidate all these various petitions, and to establish a briefing schedule, was granted. The petitions have been consolidated and a single briefing schedule established. Additionally, on October 6, 2006, Alcoa filed a petition challenging BPA's execution of a surplus power sales contract to serve Port Townsend Paper, a small direct service industrial customer. This case is directly related to the other consolidated cases. If the court does not consolidate this case with the other consolidated cases BPA may file a motion to do so.

California Parties' Refund Claims

Three California investor-owned utilities (SCE, PG&E and SDG&E), the California Electricity Oversight Board, and the California Attorney General's Office on behalf of the California Department of Water Resources filed claims for refunds from BPA under the Contract Disputes Act in late December 2005. The claimed refunds amount to approximately $310 million in connection with BPA's energy transactions in the California Power Exchange and California Independent System Operator markets between May 2000 and June 2001. A FERC proceeding is determining the amount of refunds due from jurisdictional sellers, but the Ninth Circuit Court has determined that FERC has no authority to order non-jurisdictional sellers such as BPA to make refunds.

BPA has rejected the claims on the basis that no contract violation has yet occurred because of the ongoing nature of the FERC refund proceeding. California parties have not initiated litigation, but will likely do so on the theory that BPA is obligated by contract to abide by the FERC refund orders.

Rates

BPA's rates are frequently the subject of litigation. Most of the litigation involves claims that BPA's rates are inconsistent with statutory directives, are not supported by substantial evidence in the record or are arbitrary and capricious. It is the opinion of BPA's General Counsel that if any rate were to be rejected, the sole remedy accorded would be a remand to BPA to establish a new rate. BPA's flexibility in establishing rates could be restricted by the rejection of a BPA rate, depending on the grounds for the rejection. BPA is unable to predict, however, what new rate it would establish if a rate were rejected. If BPA were to establish a rate that was lower than the rejected rate, a petitioner may be entitled to a refund in the amount overpaid. However, BPA is required by law to set rates to meet all of its costs; provided, however, that in the case of FERC ordered transmission rates no such rate shall be unjust, unreasonable or unduly discriminatory. Thus, it is the opinion of BPA's General Counsel that BPA may be required to increase its rates to seek to recover the amount of any such refunds, if needed.

Other

The FCRPS may be affected by various other legal claims, actions and complaints, including litigation under the Endangered Species Act, which may include BPA as a named party. Certain of these cases may involve material amounts. BPA is unable to predict whether the FCRPS will avoid adverse outcomes in these legal proceedings or, if not, what the impact might be. BPA currently believes that disposition of these matters will not have a materially adverse effect on the FCRPS' financial position or results of operations for fiscal year 2006.

Judgments and settlements are included in BPA's costs and recovered through rates. Except with respect to the SCE matter discussed above, BPA management has not recorded a liability for the above legal matters.

8. Segments

BPA follows FERC's open-access rulemaking and standards of conduct. FERC requires that transmission activities are functionally separate from wholesale power merchant functions and that transmission is provided in a nondiscriminatory open-access manner.

The FCRPS' major operating segments are defined by the utility functions of generation and transmission. The Power Business Line represents the operations of the generation function, while the Transmission Business Line represents the operations of the transmission function. The business lines are not separate legal entities. "Other" represents items that are necessary to reconcile to the financial statements. These items generally include shared activity such as debt management actions and inter-business unit eliminations. The FCRPS segments operate predominantly in one industry and geographic region, generation and transmission of electric power in the Pacific Northwest.

The FCRPS centrally manages all interest expense activity. Since BPA has one fund with the U.S. Treasury, all cash and cash transactions are also centrally managed. Unaffiliated revenues represent sales to external customers for each segment. Inter-segment transactions are eliminated.

During fiscal years 2006, 2005, and 2004, no single customer represented 10 percent or more of the FCRPS' revenues.

Segment Reporting

For the years ended Sept. 30 — thousands of dollars

	Power	Transmission	Other	FCRPS
2006				
Unaffiliated revenues	$2,778,237	$ 641,132	$ —	$ 3,419,369
Intersegment revenues	75,423	143,207	(218,630)	—
Total operating revenues	2,853,660	784,339	(218,630)	3,419,369
Unaffiliated expenses	2,067,497	303,450	(177,420)	2,193,527
Depreciation	181,878	171,358	—	353,236
Intersegment expenses	142,562	75,423	(217,985)	—
Total operating expenses	2,391,937	550,231	(395,405)	2,546,763
Net operating revenues	461,723	234,108	176,775	872,606
Interest expense	157,609	136,761	(32,827)	261,543
Net revenues	$ 304,114	$ 97,347	$ 209,602	$ 611,063
2005				
Unaffiliated revenues	$2,740,700	$ 527,383	$ —	$ 3,268,083
Intersegment revenues	73,524	107,147	(180,671)	—
Total operating revenues	2,814,224	634,530	(180,671)	3,268,083
Unaffiliated expenses	2,025,938	260,060	(157,669)	2,128,329
Depreciation	186,099	189,501	—	375,600
Intersegment expenses	106,510	73,524	(180,034)	—
Total operating expenses	2,318,547	523,085	(337,703)	2,503,929
Net operating revenues	495,677	111,445	157,032	764,154
Interest expense	166,610	135,754	(25,080)	277,284
Net revenues (expenses)	$ 329,067	$ (24,309)	$ 182,112	$ 486,870
2004				
Unaffiliated revenues	$2,661,975	$ 535,936	$ —	$ 3,197,911
Intersegment revenues	76,923	108,123	(185,046)	—
Total operating revenues	2,738,898	644,059	(185,046)	3,197,911
Unaffiliated expenses	1,971,620	252,738	(181,952)	2,042,406
Depreciation	177,297	188,942	—	366,239
Intersegment expenses	108,194	76,758	(184,952)	—
Total operating expenses	2,257,111	518,438	(366,904)	2,408,645
Net operating revenues	481,787	125,621	181,858	789,266
Interest expense	162,531	137,823	(15,503)	284,851
Net revenues (expenses)	$ 319,256	$ (12,202)	$ 197,361	$ 504,415

REPORT OF INDEPENDENT AUDITORS

PRICEWATERHOUSECOOPERS

To the Administrator of the
Bonneville Power Administration,
United States Department of Energy

In our opinion, the accompanying combined balance sheets and the related combined statements of revenues and expenses, of changes in capitalization and long-term liabilities and of cash flows present fairly, in all material respects, the financial position of the Federal Columbia River Power System (FCRPS) at September 30, 2006 and 2005, and the results of its operations and its cash flows for the three years in the period ended September 30, 2006, and the changes in its capitalization and long-term liabilities for the two years in the period ended September 30, 2006, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of FCRPS' management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Portland, Oregon
October 27, 2006

FEDERAL REPAYMENT

Revenue Requirement Study

The revenue requirement study demonstrates repayment of federal investment, and it reflects revenues and costs consistent with BPA's 2002 final power rate proposal in May 2000 for fiscal years 2002 through 2006 (see WP-02-FS-BPA-02) and the 2006 final transmission proposal in June 2005 for fiscal years 2006 through 2007 (see TR-06-FS-BPA-01). The final proposals filed with FERC contain the official amortization schedule for the rate periods.

Repayment Demonstration

BPA is required by Public Law 89-448 to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA net revenues within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects that are beyond the ability of irrigation water users to repay. These requirements are met by conducting power repayment studies including schedules of payments at the proposed rates to demonstrate repayment of principal within the allowable repayment period.

Since 1985, BPA has prepared separate repayment demonstrations for generation and transmission in accordance with an order issued by the Commission on Jan. 27, 1984 (26 FERC 61,096).

Repayment Policy

BPA's repayment policy is reflected in its generation and transmission revenue requirements and respective rate levels. This policy requires that FCRPS revenues by function be sufficient to:

1. Pay the cost of obtaining power through purchase and exchange agreements (nonfederal projects).
2. Pay the cost of operating and maintaining the power system including payments related to the underfunded status of the CSRS plan.
3. Pay interest on and repay outstanding bonds issued to the U.S.Treasury to finance transmission system construction, conservation, environmental, direct-funded Corps and Reclamation improvements, and fish and wildlife projects.
4. Pay interest on the unrepaid investment in facilities financed with appropriated funds. (Federal hydroelectric projects all were financed with appropriated funds, as were BPA transmission facilities constructed before 1978.)
5. Pay, with interest, any outstanding deferral of interest expense.
6. Repay the power investment in each federal hydroelectric project with interest within 50 years after the project is placed in service (except for the Chandler project, which has a legislated repayment period of 66 years).
7. Repay each increment of the investment in the BPA transmission system financed with appropriated funds with interest within the

average service life of the associated transmission plant (40 years).

8. Repay the appropriated investment in each replacement at a federal hydroelectric project within its service life.

9. Repay construction costs at federal reclamation projects that are beyond the ability of the irrigators to pay and are assigned for payment from commercial power net revenues within the same period available to the water users for making payments. These periods range from 40 to 66 years, with 50 years being applicable to most of the irrigation payment assistance.

Investments bearing the highest interest rate will be repaid first, to the extent possible, while still completing repayment of each increment of investment within its prescribed repayment period.

Repayment Obligation

BPA's rates must be designed to collect sufficient revenues to return separately the power and transmission costs of each FCRPS investment and each irrigation assistance obligation within the time prescribed by law.

If existing rates are not likely to meet this requirement, BPA must reduce costs; adjust its rates, or both. However, total irrigation assistance payments cannot require an increase in the BPA power rate level. Comparing BPA's repayment schedule for the unrepaid capital appropriations and bonds with a "term schedule" demonstrates that the federal investment will be repaid within the time allowed. A term schedule represents a repayment schedule whereby each capitalized appropriation or bond would be repaid in the year it is due.

Reporting requirements of Public Law 89-448 are met so long as the unrepaid FCRPS investment and irrigation assistance resulting from BPA's repayment schedule are less than or equal to the allowable unrepaid investment in each year. While the comparison is illustrated here by graphs representing total FCRPS generation and total FCRPS transmission investment, the actual comparison is performed on an investment-by-investment basis.

Repayment of FCRPS Investment

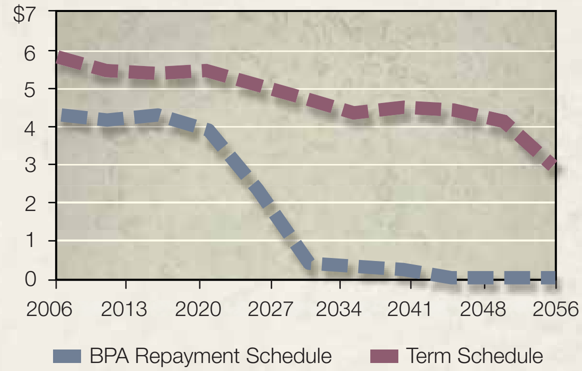
The graphs for Unrepaid Federal Generation and Transmission Investment illustrate that unrepaid investment resulting from BPA's generation and transmission repayment schedules is less than the allowable unrepaid investment. This demonstrates that BPA's rates are sufficient to recover all FCRPS investment costs on or before their due dates.

The term schedule lines in the graphs show how much of the obligation can remain unpaid in accordance with the repayment periods for the generation and transmission components of the FCRPS. The BPA repayment schedule lines show how much of the obligation remains to be repaid according to BPA's repayment schedules. In each year, BPA's repayment schedule is ahead of the term schedule. This occurs because BPA plans repayment both to comply with obligation due dates and to minimize costs over the entire repayment study horizon (40 years for transmission, 50 years for generation). Repaying highest interest-bearing investments first, to the extent possible minimizes costs. Consequently, some investments are repaid before their due dates while assuring that all other obligations are repaid by their due dates. These graphs include forecasts of system replacements during the repayment study horizon that are necessary to maintain the existing FCRPS generation and transmission facilities. The Unrepaid Federal Investment graph displays the total planned unrepaid FCRPS obligations compared to allowable total unrepaid FCRPS investment, omitting future system replacements. This demonstrates that each FCRPS investment through 2006 is scheduled to be returned to the U.S. Treasury within its repayment period and ahead of due dates.

If, in any given year, revenues are not sufficient to cover all cash needs including interest, any deficiency becomes an unpaid annual expense. Interest is accrued on the unpaid annual expense until paid. This must be paid from subsequent years' revenues before any repayment of federal appropriations can be made.

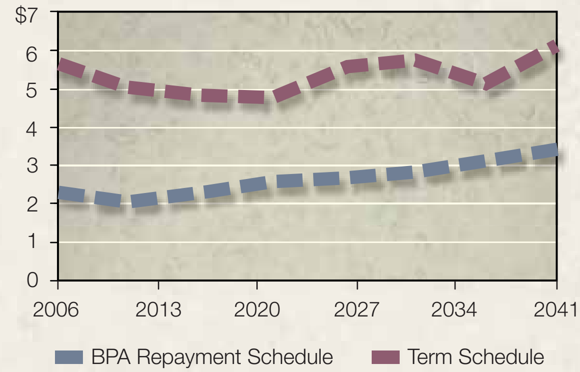
Unrepaid Federal Generation Investment

Includes future replacements — billions of dollars



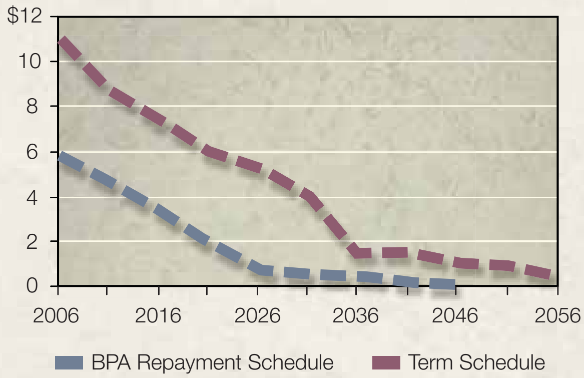
Unrepaid Federal Transmission Investment

Includes future replacements — billions of dollars



Unrepaid Federal Investment

Excludes future replacements — billions of dollars



BPA EXECUTIVES

Stephen J. Wright
Administrator and Chief Executive Officer

Steven G. Hickok
Deputy Administrator

Ruth B. Bennett
Chief Operating Officer

David J. Armstrong
Executive Vice President, Finance, and Chief Financial Officer

Chuck Meyer
Executive Vice President, Planning and Governance

Randy A. Roach
Executive Vice President and General Counsel

Roy Smithey (acting)
Executive Vice President, Internal Business Services

Larry D. Buttress
Vice President, Information Technology, and Chief Information Officer

Gregory K. Delwiche
Vice President, Environment, Fish and Wildlife

Michael J. Weedall
Vice President, Energy Efficiency

Christy Brannon
Chief Public Affairs Officer

Power Services

Paul E. Norman
Senior Vice President, Power Services

Allen L. Burns
Vice President, Bulk Marketing

Mark O. Gendron
Vice President, Northwest Requirements Marketing

Stephen R. Oliver
Vice President, Generation Asset Management

Transmission Services

Vickie VanZandt
Senior Vice President, Transmission Services

Alan L. Courts (acting)
Vice President, Engineering and Technical Services

Robin R. Furrer
Vice President, Transmission Field Services

Nancy Morgan (acting)
Vice President, Transmission Marketing

Brian L. Silverstein
Vice President, Planning and Asset Management

BPA OFFICES

BPA Headquarters
905 N.E. 11th Ave.
P.O. Box 3621
Portland, OR 97208
(503) 230-3000

BPA Public Information Center
905 N.E. 11th Ave.
P.O. Box 3621
Portland, OR 97208
(503) 230-7334
1-800-622-4520

Power Services

Bend Customer Service Center
1011 S.W. Emkay Dr., Suite 211
Bend, OR 97702
(541) 318-1680

Montana Customer Service Center
P.O. Box 140
Dayton, MT 59914
(406) 849-5034

Burley Customer Service Center
2700 Overland
Burley, ID 83318
(208) 678-9481

Eastern Area Customer Service Center
707 W. Main Ave., Suite 500
Spokane, WA 99201
(509) 358-7409

Richland Customer Service Center
Kootenai Bldg., Room 215
North Power Plant Loop
P.O. Box 968
Richland, WA 99352
(509) 372-5771

Seattle Customer Service Center
909 First Ave., Suite 380
Seattle, WA 98104-3636
(206) 220-6759

Western Area Customer Service Center
905 N.E. 11th Ave.
P.O. Box 3621
Portland, OR 97208
(503) 230-3584

Transmission Services

Transmission Services Headquarters
P.O. Box 491
Vancouver, WA 98666-0491
(360) 418-2000

Eugene Regional Office
86000 Hwy. 99 S.
Eugene, OR 97405
(541) 988-7403

Idaho Falls Regional Office
1350 Lindsay Blvd.
Idaho Falls, ID 83402
(208) 524-8750

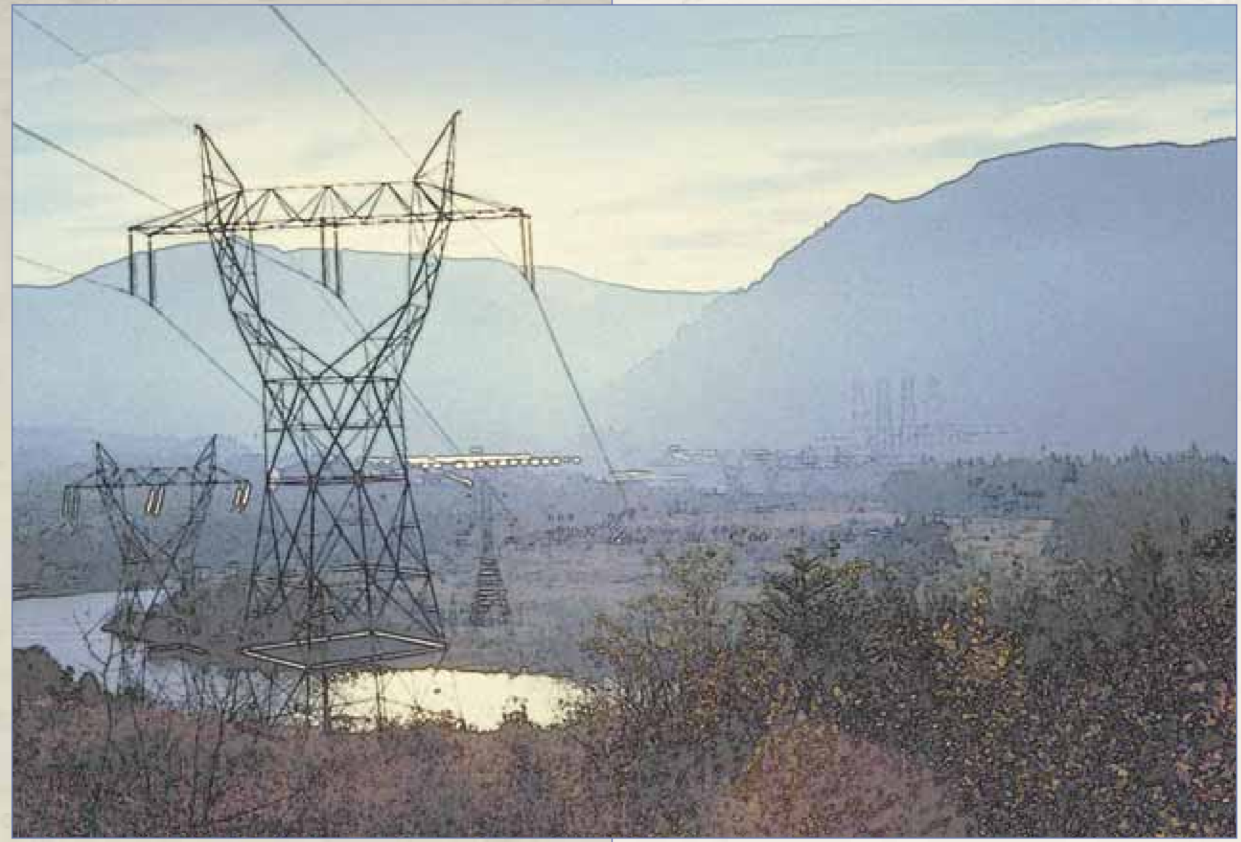
Olympia Regional Office
5240 Trosper Rd. S.W.
Olympia, WA 98512-5623
(360) 570-4303

Redmond Regional Office
3655 S.W. Highland Ave.
Redmond, OR 97756
(541) 548-4015 Ext. 3225

Snohomish Regional Office
914 Ave. D
Snohomish, WA 98290
(360) 568-4962

Spokane Regional Office
2410 E. Hawthorne Rd.
Mead, WA 99201
(509) 358-7376

Walla Walla Regional Office
6 W. Rose St., Suite 400
Walla Walla, WA 99362
(509) 527-6241



BPA PROFILE

The Bonneville Power Administration is a not-for-profit federal agency under the Department of Energy. Based in the Pacific Northwest, the agency markets wholesale electrical power from 31 federal hydro projects, one nonfederal nuclear plant and several other small nonfederal power plants. About 35 percent of the electric power used in the Northwest comes from BPA. BPA also operates and maintains about three-fourths of the region's high-voltage transmission.

BPA is a self-funding agency that covers its costs by selling its services wholesale at cost to the region's public utilities, municipalities, investor-owned utilities and some large industries. BPA also sells or exchanges power with marketers and utilities in Canada and the western United States. Its service area includes Oregon, Washington, Idaho, western Montana and small parts of Wyoming, Nevada, Utah, California and eastern Montana.

BPA is committed to providing public service and seeks to make its decisions in a manner that provides opportunities for input from all stakeholders.

As part of its public service, BPA promotes energy efficiency, renewable energy and new technologies. The agency funds regional efforts to protect and rebuild fish and wildlife populations affected by hydropower development in the Columbia River Basin.

In its vision statement, BPA dedicates itself to providing high system reliability, low rates consistent with sound business principles, environmental stewardship and accountability to the Pacific Northwest.

www.bpa.gov

Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208-3621

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