

Management's Discussion & Analysis

General

The Bonneville Power Administration is proud to serve the 12 million people residing in the 300,000 square mile region known as the Pacific Northwest, which includes the states of Idaho, Oregon, Washington, western Montana, and small parts of western Wyoming, northern Nevada and northern California. BPA supplies nearly 35 percent of the electric power consumed in this region through wholesale power contracts with more than 100 publicly and cooperatively owned utilities. About 80 percent of this power comes from hydroelectric generation. The agency owns and operates three-fourths of the high-voltage transmission lines in the region.

Headquartered in Portland, Ore., BPA is a federal power marketing administration within the U.S. Department of Energy that is also a separate and distinct legal entity. Many of BPA's statutory authorities are vested in the Secretary of Energy, who appoints and acts by and through the BPA Administrator. Other statutory authorities are vested directly in the Administrator.

Congress created BPA in 1937 to market electricity from Bonneville Dam on the Columbia River and to construct transmission facilities for that power. Today, BPA markets wholesale power from 31 federal hydroelectric projects, most of which are located in the Columbia River Basin. BPA also markets power from Energy Northwest's Columbia Generating Station nuclear power plant and the Cowlitz Falls hydro project.

BPA sells power and transmission services at cost and recovers through its power and transmission rates all costs of the Federal Columbia River Power System. BPA repays with interest the federal investment in the hydropower and transmission facilities of the FCRPS. Although BPA is not under the jurisdiction of the Federal Energy Regulatory Commission for most of its operations, it voluntarily provides open access, non-discriminatory transmission service to all requestors. In addition, BPA conforms to FERC standards of conduct to ensure its transmission function does not discriminatorily advantage its merchant power function.

BPA's largely hydroelectric power supply depends on the amount and shape of annual precipitation in the Columbia River Basin. BPA assumes the lowest historical runoff as the basis for calculating its available power supply to meet its firm power obligations. When available generation is in excess of what is needed to serve the region's obligations BPA sells this secondary energy to purchasers in the Western Interconnection at market prices. When setting power rates BPA assumes an average level of secondary energy sales. In an average water year BPA has for sale about 1,400 to 1,600 average megawatts of secondary energy. Because precipitation and market prices vary widely, BPA builds contingencies into its rates to cover poor hydro conditions. To ensure BPA is able to meet its financial responsibilities to

counterparties and to the U.S. Treasury, BPA relies on risk mitigation measures such as accumulations of financial reserves and cost recovery adjustment clauses. Snow pack in the Columbia River drainage drives each year's water and secondary energy supply, which BPA monitors to predict future supply levels. During the first quarter of the fiscal year there is a wide range of possible outcomes for the water year and consequently for BPA's revenues.

In May 2007, the United States Court of Appeals for the Ninth Circuit ruled invalid Residential Exchange Program settlements BPA had been operating under since 2001. The ruling effectively requires the agency to revisit its Residential Exchange Program. Due to the uncertainty created by the rulings, BPA suspended payments that normally reduce rates for residential and small-farm customers served by Northwest investor-owned utilities. The affected investor-owned utilities are Portland General Electric, PacifiCorp, Avista, Puget Sound Energy, Idaho Power and NorthWestern Energy. A new program is scheduled to be in place by Oct. 1, 2008.

The FCRPS financial statements that follow are a combination of the accounts of the Bonneville Power Administration, the accounts of the Pacific Northwest generating facilities of both the U.S. Army Corps of Engineers and the Bureau of Reclamation as well as the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan Facilities. Consolidated with BPA are "Special Purpose Corporations" known as Northwest Infrastructure Financing Corporations, from which BPA leases certain transmission facilities.

Results of Operations

Operating Revenues

For the three months ended Dec. 31, 2007, sales revenues from electricity and transmission were down \$27 million, or 3 percent when compared to the comparable period a year earlier. Power Services sales including bookouts declined \$30 million or 5 percent while Transmission Services sales increased \$3 million, or 2 percent. The decline is primarily the result of reduced secondary sales and reduced sales outside the Northwest Region.

The change in the unrealized fair value of BPA's derivative mark-to-market portfolio was due to fluctuations in the forward price curves, physical delivery and a change in the overall portfolio mix.

Operating Expenses

In total, operating expenses increased \$28 million, or 4 percent from the first quarter of fiscal year 2007.

Operations and maintenance decreased \$26 million, or 7 percent for the three months ended Dec. 31, 2007, from the comparable period a year earlier. The higher amount last year was primarily due to settlement of litigation over BPA's Slice of the System power product.

Purchased power increased \$22 million, or 20 percent compared to the three months ended Dec. 31, 2006. The change was due to a combination of higher prices and purchases as a consequence of lower stream flows and associated federal generation.

Nonfederal projects costs increased \$33 million or 38 percent due to higher debt service expense for Energy Northwest. The increase is the result of planned extension of nonfederal debt and early repayment of federal debt within the total FCRPS debt portfolio. The overall objective of these debt management actions is to reduce costs and achieve an optimal total debt portfolio. The portfolio includes federal appropriations, bonds issued to the U. S. Treasury, and nonfederal projects debt.

Net Interest Expense

Net interest expense for the three months ended Dec. 31, 2007, decreased \$8 million, or 12 percent, compared to the same period a year ago.

Interest expense on appropriated funds decreased \$1 million or 3 percent. Interest expense for bonds issued to the U.S. Treasury decreased \$2 million, or 5 percent.

Interest income from higher cash balances and allowance for funds used during construction collectively reduced interest expense by \$5 million. During the three months ended Dec. 31, 2007, interest income increased 22 percent and AFUDC increased 35 percent compared to the same period a year ago.

Liquidity and Capital Resources

Net Revenues and Operating Activities

As a result of the factors previously discussed, the FCRPS earned net revenues of \$34 million for the three months ended Dec. 31, 2007. By comparison, net revenues were \$93 million for the three months ended Dec. 31, 2006.

Cash provided by operating activities of the FCRPS decreased \$42 million to \$122 million for the three months ended Dec. 31, 2007, compared to \$164 million for the three months ended Dec. 31, 2006. Other assets and liabilities include three monthly deferred payments of \$28 million for suspended IOU exchange benefits, resulting in an \$84 million increase for the quarter. The change in operating cash flow primarily reflects the changes in net revenues, derivatives, and differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities.

Investment Activities

Cash used for investment activities of the FCRPS increased \$8 million to \$98 million for the three months ended Dec. 31, 2007, from increased spending for Columbia River Fish Mitigation investments. Federal utility plant assets decreased cash by \$97 million while a reduction in nonfederal generation assets increased cash by \$5 million. Nonfederal nuclear decommissioning trusts decreased cash by \$2 million. Special purpose corporation's trust funds decreased cash by \$5 million.

Financing Activities

Cash provided by financing activities of the FCRPS was \$2 million for the three months ended Dec. 31, 2007, compared to \$25 million cash used for financing activities for the three months ended Dec. 31, 2006. For the three months ended Dec. 31, 2007, cash increased \$22 million from federal construction appropriations for the Corps of Engineers and the Bureau of Reclamation and approximately \$1 million from nonfederal debt while cash decreased by \$20 million for redemption of bonds issued to the U.S. Treasury and approximately \$1 million for a reduction in customer's advances for construction.

Non-GAAP Financial Information

Modified Net Revenues

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. Modified net revenues are net revenues after removing the effects of SFAS 133 derivative mark-to-market and nonfederal debt management actions that differ from rate case assumptions.

Modified net revenues were \$19 million lower for the three months ended Dec. 31, 2007, compared to the three months ended Dec. 31, 2006, primarily due to the decline in net revenues previously discussed. The table below demonstrates the calculation for modified net revenues.

Modified Net Revenues

*Federal Columbia River Power System
For the quarters ended December 31 — thousands of dollars*

	2007	2006
Net Revenues	\$ 34,493	\$ 92,688
SFAS 133 derivative mark-to-market	16,120	238
Nonfederal debt management actions	(35,760)	(59,168)
Modified net revenues	\$ 14,853	\$ 33,758

Additional Information

To see BPA's most recent annual report including audited financial statements, go to www.bpa.gov/corporate/finance/a_report

To see BPA's news, go to www.bpa.gov/corporate/BPAnews

For general information about BPA, refer to BPA's Home page at www.bpa.gov

For information on Power Services including rates, go to www.bpa.gov/power

For information about hydro power or current hydrological information, go to www.bpa.gov/power/pgf/hydrology/weekly.shtml

For information on Transmission Services including rates, go to www.transmission.bpa.gov

Federal Columbia River Power System

Combined Balance Sheets

(Unaudited)

December 31,

2007

September 30,

2007

(thousands of dollars)

<u>Assets</u>		
Federal utility plant		
Completed plant	\$ 13,265,217	\$ 13,278,856
Accumulated depreciation	(4,855,050)	(4,825,295)
	8,410,167	8,453,561
Construction work in progress	921,001	851,620
Net federal utility plant	9,331,168	9,305,181
Nonfederal generation	2,460,300	2,465,230
Current assets		
Cash	1,501,234	1,475,544
Accounts receivable, net of allowance	102,464	140,335
Accrued unbilled revenues	237,889	181,526
Materials and supplies, at average cost	74,981	68,334
Prepaid expenses	44,371	19,938
Total current assets	1,960,939	1,885,677
Other assets		
Regulatory assets	5,831,419	5,938,724
Nonfederal nuclear decommissioning trusts	164,641	162,438
Deferred charges and other	190,896	206,398
Total other assets	6,186,956	6,307,560
Total assets	\$ 19,939,363	\$ 19,963,648
<u>Capitalization and Liabilities</u>		
Capitalization and long-term liabilities		
Accumulated net revenues	\$ 2,437,058	\$ 2,402,565
Federal appropriations	4,348,836	4,326,688
Bonds issued to U.S. Treasury	1,725,900	1,760,900
Nonfederal debt	6,262,532	6,262,295
Total capitalization and long-term liabilities	14,774,326	14,752,448
Commitments and contingencies (See Note 9 to annual financial statements)		
Current liabilities		
Federal appropriations	10,913	10,913
Bonds issued to U.S. Treasury	494,600	479,600
Nonfederal debt	289,158	288,758
Accounts payable and other	560,515	346,352
Total current liabilities	1,355,186	1,125,623
Other Liabilities		
Regulatory liabilities	2,036,990	2,050,228
IOU exchange benefits	821,262	1,068,217
Asset retirement obligations	177,000	175,500
Deferred credits	774,599	791,632
Total other liabilities	3,809,851	4,085,577
Total capitalization and liabilities	\$ 19,939,363	\$ 19,963,648

Federal Columbia River Power System
Combined Statements of Revenues and Expenses
(Unaudited)

	Three Months Ended December 31,		Fiscal Year-to-Date Ended December 31,	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(thousands of dollars)			
Operating revenues	\$ 781,320	\$ 818,928	\$ 781,320	\$ 818,928
Operating expenses				
Operations and maintenance	347,565	373,437	347,565	373,437
Purchased power	133,841	111,759	133,841	111,759
Nonfederal projects	121,274	87,956	121,274	87,956
Depreciation and amortization	88,531	89,675	88,531	89,675
Total operating expenses	691,211	662,827	691,211	662,827
Net operating revenues	90,109	156,101	90,109	156,101
Interest (income) and expense				
Interest on federal investment:				
Appropriated funds	49,078	50,384	49,078	50,384
Bonds issued to U.S. Treasury	30,773	32,463	30,773	32,463
Allowance for funds used during construction	(5,706)	(4,235)	(5,706)	(4,235)
Interest income	(18,529)	(15,199)	(18,529)	(15,199)
Net interest expense	55,616	63,413	55,616	63,413
Net revenues	\$ 34,493	\$ 92,688	\$ 34,493	\$ 92,688

Federal Columbia River Power System

Combined Statements of Cash Flows

(Unaudited)

Fiscal Year-to-Date Ended
December 31,

2007

2006

(thousands of dollars)

Cash provided by operating activities

Net revenues	\$	34,493	\$	92,688
Non-cash items:				
Depreciation and amortization		88,531		89,675
Amortization of capitalization adjustment		(16,226)		(16,226)
Changes in:				
Receivables and unbilled revenues		(18,491)		(4,367)
Materials and supplies		(6,648)		(3,975)
Prepaid expenses		(24,434)		(5,983)
Accounts payable and other		(35,733)		(5,124)
Other assets and liabilities		100,651		17,595
Cash provided by operating activities		122,143		164,283

Cash provided by and (used for) investment activities

Investment in:				
Federal utility plant (including AFUDC)		(96,837)		(94,721)
Nonfederal generation		4,930		4,700
Nonfederal nuclear decommissioning trusts		(1,780)		-
Special purpose corporation's trust funds:				
Deposits to		(9,951)		-
Receipts from		5,184		-
Cash used for investment activities		(98,454)		(90,021)

Cash provided by and (used for) financing activities

Increase (repayment):				
Federal construction appropriations		22,148		24,067
Bonds issued to U.S. Treasury		(20,000)		(40,000)
Nonfederal debt		637		(8,895)
Customer's advances for construction		(784)		-
Cash provided by (used for) financing activities		2,001		(24,828)

Increase in cash		25,690		49,434
Beginning cash balance		1,475,544		1,225,075
Ending cash balance	\$	1,501,234	\$	1,274,509

Federal Columbia River Power System

Segment Reporting

(Unaudited)

Three Months Ended

December 31,

2007

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 607,499	\$ 161,306	\$ -	\$ 768,805
Bookouts	(11,759)	-	-	(11,759)
Derivative mark-to-market	(16,120)	-	-	(16,120)
Miscellaneous revenues	8,101	9,339	-	17,440
U.S. Treasury credits for fish	22,954	-	-	22,954
Total unaffiliated revenues	610,675	170,645	-	781,320
Intersegment revenues	15,221	26,741	(41,962)	-
Total operating revenues	625,896	197,386	(41,962)	781,320
Operating expenses				
Unaffiliated expenses	545,018	69,870	(12,208)	602,680
Depreciation	44,642	43,889	-	88,531
Intersegment expenses	26,741	15,221	(41,962)	-
Total operating expenses	616,401	128,980	(54,170)	691,211
Net operating revenues	9,495	68,406	12,208	90,109
Interest expense				
Interest expense	50,741	36,638	(13,234)	74,145
Interest income	(14,363)	(4,166)	-	(18,529)
Net interest expense	36,378	32,472	(13,234)	55,616
Net (expenses) revenues	\$ (26,883)	\$ 35,934	\$ 25,442	\$ 34,493

2006

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 649,279	\$ 158,473	\$ -	\$ 807,752
Bookouts	(23,750)	-	-	(23,750)
Derivative mark-to-market	(238)	-	-	(238)
Miscellaneous revenues	8,861	7,778	-	16,639
U.S. Treasury credits for fish	18,525	-	-	18,525
Total unaffiliated revenues	652,677	166,251	-	818,928
Intersegment revenues	18,438	28,074	(46,512)	-
Total operating revenues	671,115	194,325	(46,512)	818,928
Operating expenses				
Unaffiliated expenses	546,478	65,608	(38,934)	573,152
Depreciation	45,370	44,305	-	89,675
Intersegment expenses	27,977	18,437	(46,414)	-
Total operating expenses	619,825	128,350	(85,348)	662,827
Net operating revenues	51,290	65,975	38,836	156,101
Interest expense				
Interest expense	51,690	37,697	(10,775)	78,612
Interest income	(11,511)	(3,688)	-	(15,199)
Net interest expense	40,179	34,009	(10,775)	63,413
Net revenues	\$ 11,111	\$ 31,966	\$ 49,611	\$ 92,688

Derivative instruments and hedging activities

The derivative mark-to-market amount is an "accounting only" (no cash impact) adjustment representing the adjustment required by SFAS 133, as amended, for identified derivative instruments.

Federal Columbia River Power System

Segment Reporting

(Unaudited)

Fiscal Year-to-Date Ended

December 31,

2007

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 607,499	\$ 161,306	\$ -	\$ 768,805
Bookouts	(11,759)	-	-	(11,759)
Derivative mark-to-market	(16,120)	-	-	(16,120)
Miscellaneous revenues	8,101	9,339	-	17,440
U.S. Treasury credits for fish	22,954	-	-	22,954
Total unaffiliated revenues	610,675	170,645	-	781,320
Intersegment revenues	15,221	26,741	(41,962)	-
Total operating revenues	625,896	197,386	(41,962)	781,320
Operating expenses				
Unaffiliated expenses	545,018	69,870	(12,208)	602,680
Depreciation	44,642	43,889	-	88,531
Intersegment expenses	26,741	15,221	(41,962)	-
Total operating expenses	616,401	128,980	(54,170)	691,211
Net operating revenues	9,495	68,406	12,208	90,109
Interest expense				
Interest expense	50,741	36,638	(13,234)	74,145
Interest income	(14,363)	(4,166)	-	(18,529)
Net interest expense	36,378	32,472	(13,234)	55,616
Net (expenses) revenues	\$ (26,883)	\$ 35,934	\$ 25,442	\$ 34,493

2006

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 649,279	\$ 158,473	\$ -	\$ 807,752
Bookouts	(23,750)	-	-	(23,750)
Derivative mark-to-market	(238)	-	-	(238)
Miscellaneous revenues	8,861	7,778	-	16,639
U.S. Treasury credits for fish	18,525	-	-	18,525
Total unaffiliated revenues	652,677	166,251	-	818,928
Intersegment revenues	18,438	28,074	(46,512)	-
Total operating revenues	671,115	194,325	(46,512)	818,928
Operating expenses				
Unaffiliated expenses	546,478	65,608	(38,934)	573,152
Depreciation	45,370	44,305	-	89,675
Intersegment expenses	27,977	18,437	(46,414)	-
Total operating expenses	619,825	128,350	(85,348)	662,827
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Interest expense	51,690	37,697	(10,775)	78,612
Interest income	(11,511)	(3,688)	-	(15,199)
Net interest expense	40,179	34,009	(10,775)	63,413
Net revenues	\$ 11,111	\$ 31,966	\$ 49,611	\$ 92,688

Operating Segments

In fiscal year 1997 BPA opted to implement 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. Power Services represents the operations of the generation function, while Transmission Services represents the operations of the transmission function. Power and Transmission Services are not separate legal entities. Each FCRPS segment operates predominantly in one industry and geographic region: the generation and transmission for electric power in the Pacific Northwest.

Where applicable, "Other" represents items that are necessary to reconcile to the financial statements, which generally include Corporate shared activities which is primarily income due to debt reassignment and eliminations.

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. Intersegment revenues are eliminated.

Major Customers

During fiscal 2007, and 2006, no single customer represented 10% or more of the FCRPS' revenues.