



## 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 to deliver 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 monitors snow pack that drains into the Columbia River basin to predict each year's water and secondary energy supply. BPA assumes the lowest historical runoff as the basis for calculating its available power supply to meet its firm power obligations. BPA sells secondary energy to purchasers in the Western Interconnection at market prices when available generation is in excess of what is needed to serve the region's obligations. When setting power rates, BPA assumes an average level of secondary energy sales. In an average water year BPA has about 1,400 to 1,600 average

megawatts of secondary energy available for sale. 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 financial reserves and cost recovery adjustment clauses in rates.

The FCRPS financial statements that follow are a combination of the accounts of BPA, 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.

## Residential Exchange Program

BPA implements the Residential Exchange Program, which provides benefits of the Federal hydro system to residential and small farm customers of qualifying regional utilities through an exchange of power that results in direct payments to the utilities. The cost of this program is included in BPA's rates. In May 2007, the Ninth Circuit Court of Appeals ruled that BPA's October 2000 REP Settlement Agreements were inconsistent with the Northwest Power Act. Since that ruling BPA has developed a revised Average System Cost Methodology, draft contracts to implement the REP and a proposed remedy for excess REP settlement payments made during fiscal years 2002 through 2007. BPA's initial fiscal year 2007 Supplemental Rate Case Proposal identified a "Lookback Amount" of approximately \$620 million, representing excess REP settlement payments to the Investor-Owned Utilities over that period.

While there are remaining uncertainties associated with the ultimate resolution of the REP issues, management believes it is likely the rate principles and the "Lookback Amount" described above will be resolved in the Final Record of Decision, the prevailing rate order in BPA's circumstances, to be issued in September 2008 and will be accounted for in future rate cases until fully amortized. As such, a regulatory asset due from the IOUs and a regulatory liability due to the Publics of \$620 million, respectively, have been recorded in the quarter ended June 30, 2008, based upon BPA's initial fiscal year 2007 Supplemental Rate Case Proposal, the best information available at this time.

In connection with adjustments to regulatory accounts described above, BPA adjusted its REP liabilities and regulatory accounts that relate to the REP Settlement Agreements which were effectively eliminated by the actions described above. As a result, long-term REP liabilities and long-term regulatory assets were reduced by \$644 million. None of these adjustments impacted net revenues during the period.

# Results of Operations

## *Operating Revenues*

For the nine months in the fiscal year-to-date ended June 30, 2008, revenues from combined Power Services and Transmission Services sales increased \$4 million, less than 1 percent from the comparable period a year earlier, as reported under Segment Reporting. Power Services sales declined \$12 million or 1 percent. The decline is the result of delayed runoff reducing federal generation available for secondary sales. This decline was partially offset by higher market prices. Transmission Services sales increased \$16 million, or 3 percent. Several factors resulted in the increase. These include increased network and intertie transmission sales and associated ancillary services, increased point-to-point long-term sales and a slight increase in point-to-point and Intertie long-term rates from last fiscal year.

The decrease in the unrealized fair value of BPA's derivative portfolio of \$28 million was due to fluctuations in the forward prices curves, physical delivery and a change in the overall portfolio mix.

U.S. Treasury credits for fish increased \$19 million, or 34 percent as stream flows declined and market prices for purchased power increased.

## *Operating Expenses*

Operations and maintenance decreased \$70 million, or 6 percent for the nine months ended June 30, 2008, from the comparable period a year earlier, as reported below in the Combined Statements of Revenues and Expenses. The higher amount last year was due to settlement of litigation over BPA's Slice of the System power product and the bi-annual refueling of Energy Northwest's Columbia Generating Station nuclear power plant.

Purchased power increased \$126 million, or 55 percent, due to a combination of higher prices and increased purchases as a consequence of delayed runoff and the associated reduction in federal generation.

Nonfederal projects debt service increased \$146 million or 66 percent due to increased amortization for Energy Northwest's Nuclear Project No. 1 and Project No. 3 bonds. During both periods early federal debt repayments were made in lieu of nonfederal debt. Higher debt optimization during the prior period resulted in lower nonfederal projects debt service. The overall objective of these debt management actions has been to achieve an optimal total debt portfolio. The portfolio includes federal appropriations, U.S. Treasury borrowings, and nonfederal projects debt. Refer to modified net revenues below.

## *Net Interest Expense*

Interest on U.S. Treasury borrowings declined \$6 million, or 6 percent for the nine months ended June 30, 2008, from the comparable period a year earlier. The primary driver was a reduction of debt

outstanding between periods. Allowance for funds used during construction increased \$7 million, or 63 percent with corresponding increases of construction work in progress for federal hydro generation plant and Columbia River fish mitigation. Interest income increased \$6 million, or 12 percent due to higher cash balances.

## Liquidity and Capital Resources

### *Net Revenues and Operating Activities*

As a result of the factors previously discussed, the FCRPS earned net revenues of \$291 million for the nine months ended June 30, 2008. By comparison, net revenues were \$479 million for the nine months ended June 30, 2007.

Cash provided by operating activities of the FCRPS decreased \$488 million to \$413 million for the nine months ended June 30, 2008, compared to \$901 million for the comparable period a year earlier, as reported below in the Combined Statements of Cash Flows. The change in operating cash flow primarily reflects the changes in net revenues, net of the impact of changing derivative values, and differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities. The net change attributable to the REP was \$85 million.

### *Investment Activities*

Cash used for investment activities of the FCRPS increased \$66 million to \$356 million for the nine months ended June 30, 2008. A significant change between the periods was a transfer to BPA from the federal Spectrum Relocation Fund. During the second quarter of fiscal year 2007, BPA received approximately \$49 million to offset costs associated with relocating radio communications from displaced spectrum bands resulting from the National Telecommunications and Information Administration Organization Act. As such, the receipts were reflected as a source of investing cash. Another significant change between the periods was net deposits to the Special Purpose Corporation's trust funds of \$32 million of proceeds from the Lease Financing Program in 2008 fiscal year-to-date.

### *Financing Activities*

Cash provided by financing activities of the FCRPS was \$100 million for the nine months ended June 30, 2008, compared to \$55 million for the comparable period a year earlier. A net decrease in U.S. Treasury borrowings of \$20 million was offset by an increase of \$63 million in Nonfederal debt, and an increase in customer's advances for construction of \$14 million. Nonfederal debt increased due to use of the Lease Financing Program through which Northwest Infrastructure Financing Corporation II incurred

debt to Citibank of \$39 million, and Northwest Infrastructure Financing Corporation III incurred debt to JPMorgan of \$30 million.

### *Banking Agreement with the U.S. Treasury*

BPA and the U.S. Treasury reached agreement in the third quarter of fiscal year 2008 to establish a new, more formal and detailed banking arrangement. The new arrangement will better meet BPA's business needs by providing greater flexibility and more certain liquidity. Under the new arrangement for borrowing, U.S. Treasury will advance funds to BPA under a series of separate obligations with terms of up to five years. This borrowing structure does not increase BPA's Treasury Borrowing Authority cap, but provides access to more borrowing instruments and ranges of maturities and replaces the historical borrowing practices. During the quarter BPA borrowed \$130 million under the new agreement.

### *Columbia Basin Fish Accords*

On May 2, 2008, BPA signed four separate agreements, known as the Columbia Basin Fish Accords, which resolve issues in the litigation over the remand of the 2004 Biological Opinion for the FCRPS. The agreements are 10-year action agency commitments for projects to benefit fish affected by the FCRPS. These agreements also include actions in support of recovery plans. BPA's Record of Decision regarding these agreements is available at [www.bpa.gov/corporate/pubs/RODS/2008/](http://www.bpa.gov/corporate/pubs/RODS/2008/). These agreements are available at [www.salmonrecovery.gov/](http://www.salmonrecovery.gov/).

## 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 \$45 million lower for the nine months ended June 30, 2008, compared to the comparable period a year earlier, primarily due to the decline in net revenues previously discussed.

The table below demonstrates the calculation for modified net revenues.

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## Modified Net Revenues

*Federal Columbia River Power System*

*For the fiscal year-to-date ended June 30 — thousands of dollars*

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	<b>2008</b>	<b>2007</b>
<b>Net Revenues</b>	<b>\$ 291,475</b>	\$ 478,523
SFAS 133 derivative mark-to-market	<b>26,608</b>	(1,774)
Nonfederal debt management actions	<b>(106,176)</b>	(219,929)
Modified net revenues	<b>\$ 211,907</b>	\$ 256,820

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## Additional Information

To see BPA's most recent annual report including audited financial statements, go to [www.bpa.gov/corporate/finance/a\\_report](http://www.bpa.gov/corporate/finance/a_report)

To see BPA's news including Columbia Basin Fish Accords signed in the third quarter, go to [www.bpa.gov/corporate/BPAnews](http://www.bpa.gov/corporate/BPAnews)

For general information about BPA, refer to BPA's Home page at [www.bpa.gov](http://www.bpa.gov)

For information on Power Services including rates, go to [www.bpa.gov/power](http://www.bpa.gov/power)

For information about hydro power or current hydrological information, go to [www.bpa.gov/power/pgf/hydrology/weekly.shtml](http://www.bpa.gov/power/pgf/hydrology/weekly.shtml)

For information on Transmission Services including rates, go to [www.transmission.bpa.gov](http://www.transmission.bpa.gov)

# Federal Columbia River Power System Combined Balance Sheets

(Unaudited)

June 30,  
2008

September 30,  
2007

(thousands of dollars)

## Assets

	June 30, 2008	September 30, 2007
<b>Federal utility plant</b>		
Completed plant	\$ 13,316,646	\$ 13,278,856
Accumulated depreciation	(4,934,890)	(4,825,295)
	<u>8,381,756</u>	<u>8,453,561</u>
Construction work in progress	996,406	851,620
Net federal utility plant	<u>9,378,162</u>	<u>9,305,181</u>
<b>Nonfederal generation</b>	<u>2,498,745</u>	<u>2,465,230</u>
<b>Current assets</b>		
Cash	1,632,266	1,475,544
Accounts receivable, net of allowance	118,771	140,335
Accrued unbilled revenues	284,747	181,526
Materials and supplies, at average cost	75,256	68,334
Prepaid expenses	43,271	19,938
Total current assets	<u>2,154,311</u>	<u>1,885,677</u>
<b>Other assets</b>		
Regulatory assets	5,556,939	5,938,724
Nonfederal nuclear decommissioning trusts	159,974	162,438
Deferred charges and other	211,462	206,398
Total other assets	<u>5,928,375</u>	<u>6,307,560</u>
<b>Total assets</b>	<u>\$ 19,959,593</u>	<u>\$ 19,963,648</u>

## Capitalization and Liabilities

<b>Capitalization and long-term liabilities</b>		
Accumulated net revenues	\$ 2,694,040	\$ 2,402,565
Federal appropriations	4,378,339	4,326,688
U.S. Treasury borrowings	1,715,500	1,760,900
Nonfederal debt	6,451,779	6,262,295
Total capitalization and long-term liabilities	<u>15,239,658</u>	<u>14,752,448</u>
<b>Commitments and contingencies (See Note 9 to annual financial statements)</b>		
<b>Current liabilities</b>		
Federal appropriations	10,913	10,913
U.S. Treasury borrowings	484,700	479,600
Nonfederal debt	173,553	288,758
Accounts payable and other	482,015	346,352
Total current liabilities	<u>1,151,181</u>	<u>1,125,623</u>
<b>Other Liabilities</b>		
Regulatory liabilities	2,619,944	2,050,228
IOU exchange benefits	-	1,068,217
Asset retirement obligations	158,700	175,500
Deferred credits	790,110	791,632
Total other liabilities	<u>3,568,754</u>	<u>4,085,577</u>
<b>Total capitalization and liabilities</b>	<u>\$ 19,959,593</u>	<u>\$ 19,963,648</u>

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

	Three Months Ended June 30,		Fiscal Year-to-Date Ended June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(thousands of dollars)			
<b>Operating revenues</b>	\$ 942,271	\$ 830,906	\$ 2,523,215	\$ 2,530,506
<b>Operating expenses</b>				
Operations and maintenance	384,844	401,322	1,077,732	1,148,219
Purchased power	124,287	50,567	355,709	229,769
Nonfederal projects	120,671	45,395	367,090	220,861
Depreciation and amortization	88,007	88,311	265,572	267,118
Total operating expenses	717,809	585,595	2,066,103	1,865,967
Net operating revenues	224,462	245,311	457,112	664,539
<b>Interest (income) and expense</b>				
Interest on federal investment:				
Appropriated funds	49,065	50,341	147,263	149,348
U.S. Treasury borrowings	29,967	32,500	91,495	97,224
Allowance for funds used during construction	(5,286)	(3,779)	(16,853)	(10,329)
Interest income	(18,189)	(19,260)	(56,268)	(50,227)
Net interest expense	55,557	59,802	165,637	186,016
<b>Net revenues</b>	\$ 168,905	\$ 185,509	\$ 291,475	\$ 478,523



# Federal Columbia River Power System

## Combined Statements of Cash Flows

(Unaudited)

Fiscal Year-to-Date Ended  
June 30,

2008

2007

(thousands of dollars)

### Cash provided by operating activities

Net revenues	\$ 291,475	\$ 478,523
Non-cash items:		
Depreciation and amortization	265,572	267,118
Amortization of capitalization adjustment	(48,679)	(48,679)
Changes in:		
Receivables and unbilled revenues	(81,657)	71,413
Materials and supplies	(6,923)	(3,388)
Prepaid expenses	(23,332)	(11,091)
Accounts payable and other	770	115,171
Other assets and liabilities	15,830	31,916
Cash provided by operating activities	413,056	900,983

### Cash provided by and (used for) investment activities

Investment in:		
Federal utility plant (including AFUDC)	(285,050)	(303,779)
Nonfederal generation	(33,515)	(34,445)
Transfer from Spectrum Relocation Fund	-	48,627
Nonfederal nuclear decommissioning trusts	(5,339)	-
Special purpose corporation's trust funds:		
Deposits to	(69,088)	-
Receipts from	36,952	-
Cash used for investment activities	(356,040)	(289,597)

### Cash provided by and (used for) financing activities

Increase (repayment):		
Federal construction appropriations		
Increase	51,651	63,473
Repayment	-	-
U.S. Treasury borrowings		
Increase	225,000	245,000
Repayment	(190,300)	(265,000)
Refinanced	(75,000)	-
Nonfederal debt		
Increase	83,594	20,504
Repayment	(9,315)	(8,895)
Customer's advances for construction	14,076	-
Cash provided by (used for) financing activities	99,706	55,082
Increase in cash	156,722	666,468
Beginning cash balance	1,475,544	1,225,075
Ending cash balance	\$ 1,632,266	\$ 1,891,543

# Federal Columbia River Power System

## Segment Reporting

(Unaudited)

Three Months Ended

June 30,

**2008**

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
<b>Unaffiliated revenues</b>				
Sales	\$ 725,476	\$ 169,331	\$ -	\$ 894,807
Bookouts	(32,546)	-	-	(32,546)
Derivative mark-to-market	37,824	-	-	37,824
Miscellaneous revenues	6,770	9,527	-	16,297
U.S. Treasury credits for fish	25,889	-	-	25,889
Total unaffiliated revenues	763,413	178,858	-	942,271
<b>Intersegment revenues</b>	17,540	32,139	(49,679)	-
Total operating revenues	780,953	210,997	(49,679)	942,271
<b>Operating expenses</b>				
Unaffiliated expenses	560,178	81,867	(12,243)	629,802
Depreciation	44,614	43,393	-	88,007
Intersegment expenses	32,139	17,540	(49,679)	-
Total operating expenses	636,931	142,800	(61,922)	717,809
Net operating revenues	144,022	68,197	12,243	224,462
<b>Interest expense</b>				
Interest expense	50,683	36,166	(13,103)	73,746
Interest income	(13,331)	(4,858)	-	(18,189)
Net interest expense	37,352	31,308	(13,103)	55,557
<b>Net (expenses) revenues</b>	\$ 106,670	\$ 36,889	\$ 25,346	\$ 168,905

**2007**

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
<b>Unaffiliated revenues</b>				
Sales	\$ 669,522	\$ 162,895	\$ -	\$ 832,417
Bookouts	(25,472)	-	-	(25,472)
Derivative mark-to-market	(10,509)	-	-	(10,509)
Miscellaneous revenues	8,290	8,594	-	16,884
U.S. Treasury credits for fish	17,586	-	-	17,586
Total unaffiliated revenues	659,417	171,489	-	830,906
<b>Intersegment revenues</b>	19,531	36,658	(56,189)	-
Total operating revenues	678,948	208,147	(56,189)	830,906
<b>Operating expenses</b>				
Unaffiliated expenses	462,072	74,090	(38,878)	497,284
Depreciation	43,730	44,581	-	88,311
Intersegment expenses	36,658	19,531	(56,189)	-
Total operating expenses	542,460	138,202	(95,067)	585,595
Net operating revenues	136,488	69,945	38,878	245,311
<b>Interest expense</b>				
Interest expense	51,659	38,216	(10,813)	79,062
Interest income	(14,689)	(4,571)	-	(19,260)
Net interest expense	36,970	33,645	(10,813)	59,802
<b>Net revenues</b>	\$ 99,518	\$ 36,300	\$ 49,691	\$ 185,509

### 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  
June 30,  
2008

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
<b>Unaffiliated revenues</b>				
Sales	\$ 1,994,025	\$ 502,505	\$ -	\$ 2,496,530
Bookouts	(69,261)	-	-	(69,261)
Derivative mark-to-market	(26,608)	-	-	(26,608)
Miscellaneous revenues	21,901	26,642	-	48,543
U.S. Treasury credits for fish	74,011	-	-	74,011
Total unaffiliated revenues	1,994,068	529,147	-	2,523,215
<b>Intersegment revenues</b>	48,238	85,674	(133,912)	-
Total operating revenues	2,042,306	614,821	(133,912)	2,523,215
<b>Operating expenses</b>				
Unaffiliated expenses	1,611,617	225,670	(36,756)	1,800,531
Depreciation	134,254	131,318	-	265,572
Intersegment expenses	85,674	48,238	(133,912)	-
Total operating expenses	1,831,545	405,226	(170,668)	2,066,103
Net operating revenues	210,761	209,595	36,756	457,112
<b>Interest expense</b>				
Interest expense	152,091	109,405	(39,591)	221,905
Interest income	(42,625)	(13,643)	-	(56,268)
Net interest expense	109,466	95,762	(39,591)	165,637
<b>Net (expenses) revenues</b>	\$ 101,295	\$ 113,833	\$ 76,347	\$ 291,475

2007

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
<b>Unaffiliated revenues</b>				
Sales	\$ 2,005,540	\$ 486,876	\$ -	\$ 2,492,416
Bookouts	(67,868)	-	-	(67,868)
Derivative mark-to-market	1,774	-	-	1,774
Miscellaneous revenues	25,675	23,376	-	49,051
U.S. Treasury credits for fish	55,133	-	-	55,133
Total unaffiliated revenues	2,020,254	510,252	-	2,530,506
<b>Intersegment revenues</b>	58,417	92,079	(150,496)	-
Total operating revenues	2,078,671	602,331	(150,496)	2,530,506
<b>Operating expenses</b>				
Unaffiliated expenses	1,507,906	207,731	(116,788)	1,598,849
Depreciation	133,022	134,096	-	267,118
Intersegment expenses	91,982	58,416	(150,398)	-
Total operating expenses	1,732,910	400,243	(267,186)	1,865,967
Net operating revenues	345,761	202,088	116,690	664,539
<b>Interest expense</b>				
Interest expense	154,563	114,024	(32,344)	236,243
Interest income	(37,933)	(12,294)	-	(50,227)
Net interest expense	116,630	101,730	(32,344)	186,016
Net revenues	\$ 229,131	\$ 100,358	\$ 149,034	\$ 478,523

## **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. These 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 the reported periods no single customer represented 10% or more of the FCRPS' revenues.