



BONNEVILLE POWER ADMINISTRATION
A YEAR OF COLLABORATION

08 ANNUAL
REPORT





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LETTER TO THE PRESIDENT

DEAR MR. PRESIDENT:

If I had to characterize 2008 with one word, it would be “collaboration.” The Bonneville Power Administration has made tremendous progress on many issues crucial to the Pacific Northwest thanks to effective partnerships with our customers and constituents, our fellow federal agencies, the states, Northwest tribes and many other entities. Working together is becoming deeply engrained in the Northwest’s approach to meeting challenges.

The following are significant milestones we achieved during 2008.

We issued standard language for new 20-year wholesale power contracts and expect to sign final contracts with our customers at the end of the calendar year. This is truly a momentous milestone. The contracts will conclude a Regional Dialogue we’ve conducted with our customers and other stakeholders since 2002 to determine our future power role. These new long-term contracts are scheduled to go into effect when current contracts expire in 2011. They

will give our customers the certainty they need to make resource choices for the future. This, in turn, will be a major step toward ensuring the infrastructure is in place to achieve regional resource adequacy.

Also, much of the year’s focus for our Power Services business has been on designing a new tiered rates structure, laying the groundwork for future rate cases and re-establishing a Residential Exchange Program to share federal benefits with both Northwest consumer-owned utilities (our preference customers) and investor-owned utilities in a manner that is consistent with the Northwest Power Act.

A highlight for our Transmission Services business has been development of a much more efficient method of managing the lengthy queue of customers requesting network transmission. This is particularly important because, if we are to encourage resource development, we must have adequate transmission. This year, we held our first Network Open Season to resounding



success. We are now conducting transmission expansion studies. These will help us decide the priorities for where new transmission is needed and when it will be built.

It's notable that nearly three-quarters of the network transmission agreements that were signed are associated with new wind generation projects. This highlights the importance of regional collaboration in addressing ways to integrate wind, an intermittent resource, into our power system. To this end, we are working closely with our customers, regulators and the wind power community to determine how BPA and the region can cost-effectively manage the large amounts of wind power expected to enter the Northwest grid.

No event underscored the importance of collaboration more than the groundbreaking agreements we signed this year with two other federal agencies, five Northwest tribes and two states. The agreements, known as the Columbia Basin Fish Accords, emerged out of 18 months of conversations in which we gained much better insights into what the individual parties needed and wanted. The agreements provide 10 years of stable funding for projects that will not only protect endangered salmon, but also will help keep other species from becoming endangered. The Columbia Basin Fish Accords are truly historic, signaling as they do the close of 30 years of contention and litigation and ushering in a new period of collaboration among these parties.

We also had an exceptional year in energy efficiency. In partnership with our customers, we captured over 76 average megawatts of new conservation savings in the Pacific Northwest, well above the year's

target of 52 average megawatts. This translates to the equivalent power consumption of about 65,000 households in the region.

These are just a few key highlights of an extraordinary year marked by progress and partnerships. You can read more about these and other highlights of the year in the following pages. One thing is certain, the progress we have made has been enabled by the fact that we have worked hard to forge and maintain financial stability.

Not only have we continued to make our annual payment to the U.S. Treasury on time and in full, but for the last several years we have prepaid debt. This is despite additional pressures such as growing demands for power, the need to shore up an aging transmission system, increasing fish and wildlife costs, rising costs of commodities and equipment and growing regulatory requirements including environmental, reliability and financial requirements.

We have managed to offset some of those costs and maintain low rates through a multi-year focus on efficiency, cost consciousness and delivering value. I am immensely proud of what BPA has achieved in meeting our responsibilities to both Pacific Northwest ratepayers and U.S. taxpayers.

Sincerely,



Stephen J. Wright
Administrator and CEO



FINANCIAL RESULTS

OPERATING REVENUES

billions of dollars



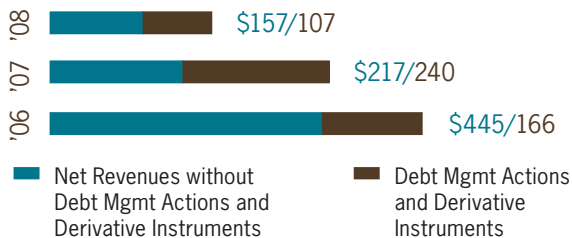
OPERATING EXPENSES

billions of dollars



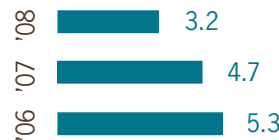
NET REVENUES WITH & WITHOUT DEBT MANAGEMENT ACTIONS & DERIVATIVE INSTRUMENTS

millions of dollars



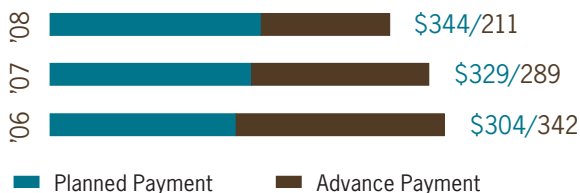
NONFEDERAL DEBT SERVICE COVERAGE RATIO

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 Derivative Instruments* reflect the impact of nonfederal debt management actions that differ from rate case assumptions and Derivative Instruments (See Derivative Instruments 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 borrowings from U.S. Treasury. *Financial Reserves* are the sum of BPA cash and deferred borrowing authority at year end.

THE YEAR IN REVIEW

FINANCE WEATHER AFFECTS PERFORMANCE

To understand the Bonneville Power Administration's financial performance, it is necessary to understand that the Pacific Northwest has a challenge — and advantage — unlike the rest of the country. Because the region's energy resource portfolio includes large amounts of hydropower, weather plays a major role in dictating our fuel supply and, thus, revenues.

This is especially true for BPA, which markets power from 31 federal dams, representing just over 80 percent of our electricity generating resources. Low or high water dramatically affects revenues derived from the sale of surplus power.

This year's weather was particularly unpredictable. With heavy snowfalls in the Northwest, many people assumed that the snow melt would produce high streamflows and an abundance of hydropower generation. Instead, the runoff for the Federal Columbia River Power System this year was below average. The final volume measured at The Dalles Dam for the January-through-July period was 99.2 million acre feet or 92 percent of the 30-year average.

For generating revenues, the shape of the runoff is nearly as important as the content. A long, cold spring produced low streamflows and depressed revenues early in the season.

In fact, streamflows in the Columbia Basin this past April were at 52 percent of average, which is the fourth lowest April measurement on record. Then a late and rapid snowmelt led to deteriorating prices for hydropower and, in some cases, spilling water (beyond fish requirements) instead of generating power. By mid-July, natural streamflows were again below normal.

YEAR-END FINANCIAL RESULTS STILL SOLID

Financial results for fiscal year 2008¹ were somewhat above agency targets, with Transmission Services substantially exceeding its targets and Power Services coming in below its target, largely due to the quantity and timing of federal generation as described above. Net revenues for 2008 were \$265 million on total operating revenues of \$3 billion, compared to \$457 million for the previous year on total operating revenues of \$3.3 billion. Adjusted for debt management actions and fluctuations in derivative market prices, BPA's modified net revenues totaled \$157 million, compared to \$217 million in 2007.

For more detailed information, see previous page.

TREASURY PAYMENT HITS BIG ANNIVERSARY

This was the 25th year in a row that we have made our payment to the U.S. Treasury on time and in full, thus proving a solid record of meeting our obligation to U.S. taxpayers. This year's payment was \$963 million, including interest and a prepayment of \$211 million to retire a portion of our Treasury debt early as part of our Debt Optimization Program.

Under this program, BPA and Energy Northwest² have collaborated for a number of years to extend the maturities of Energy Northwest bonds as they come due. Energy Northwest owns and operates the Columbia Generating Station near Richland, Wash.

Refinancing nonfederal bonds with new bonds that have extended maturities allows us to prepay some of our federal debt so we can extend use of capped borrowing authority with the U.S. Treasury. This is especially important because, if BPA is to assure reliability and adequacy in the future, we must make investments in aging infrastructure now.

BOND TRANSACTIONS PROVIDE BENEFITS

Currently BPA backs \$6 billion in bonds issued by Energy Northwest. This past spring BPA and Energy Northwest closed three bond offerings totaling \$891 million, which included refinancing certain bonds for the Debt Optimization Program, refinancing for interest rate savings, refinancing of under-performing variable rate debt, restructuring of debt to support certain rate case assumptions and, finally, financing new capital investments at Columbia Generating Station. Energy Northwest and BPA had

some exposure to the financial credit crunch, but we have taken steps to minimize the impacts. The vast majority of Energy Northwest bonds have fixed interest rates, while a relatively small portion has a variable interest rate.

We continue to monitor financial market challenges closely and are actively managing BPA's total debt portfolio to produce the lowest cost to our customers.

BOND RATINGS REMAIN STRONG

In 2008, Fitch Ratings assigned an AA- rating to Energy Northwest bonds and all other nonfederal debt backed by BPA. Fitch also signaled that even higher ratings are possible given a positive outcome for long-term power sales contracts. Two other rating agencies affirmed their high ratings of BPA-backed bonds. Standard & Poor's maintained its AA- rating, and Moody's maintained its Aaa rating.

In their ratings reports, the agencies summarized key BPA strengths: BPA's position as a leading provider of electricity and transmission in the region; the strong, efficient and economical operations of the federal hydroelectric power system; highly competitive wholesale power rates; strong demand for the economical output of the system; and a broad service territory and diverse customer base that shield BPA from utility-specific credit risks.

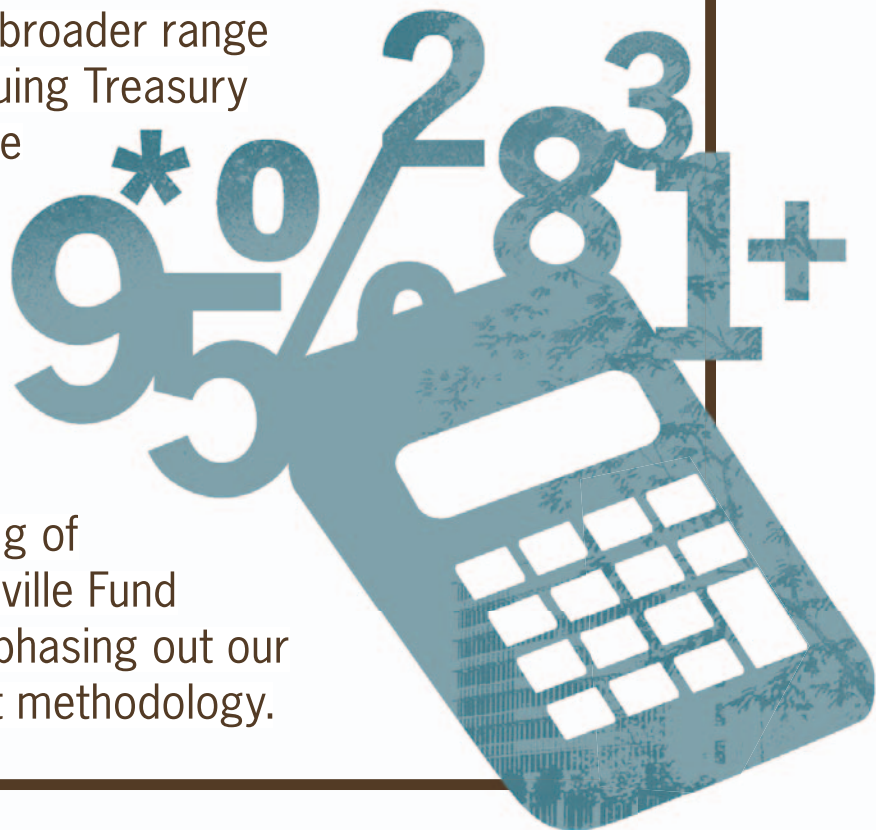
NEW FINANCIAL PLAN ROLLED OUT

In July, BPA finalized a new Financial Plan, following public review and comment. Like an earlier financial plan developed in 1993, the goal is to design financial

NEW TREASURY ARRANGEMENT MEETS MUTUAL NEEDS

BPA and the U.S. Treasury formalized a new arrangement in April 2008 that gives both agencies a more formal and flexible banking relationship that better meets our business needs and aligns our relationship with current U.S. Treasury business practices and standards. The new comprehensive arrangement covers BPA's short- and long-term federal borrowings and establishes a phased-in approach to a market-based investing program.

Under the new arrangement, BPA gains more flexibility and a broader range of alternatives for issuing Treasury debt. We also have the ability to borrow for Northwest Power Act-related operating expenses in a financial emergency. We will move to a market-based investing of deposits in the Bonneville Fund while simultaneously phasing out our current interest-offset methodology.



Our customers and constituents review our proposed costs.

strategies and policies to ensure BPA's continued ability to make our annual U.S. Treasury payments, while also providing increased rate predictability. However, the new plan reflects the fact that conditions affecting BPA's financial position have changed since the earlier plan.

Key components of the plan include the following:

Financial risk metrics: The plan reaffirms BPA's long-standing objective of having each business unit set rates to achieve a 95 percent probability of meeting its repayment obligations to the U.S. Treasury during each two-year rate period.

Access to capital: The key goals are continued access to Treasury borrowing authority and an appropriate mix of federal and nonfederal sources of capital for future investments over the next 20 years.

Good year/bad year financial planning: We are exploring appropriate ways to use the results of years of good financial performance to improve our ability to cope with years of poor financial performance.

Cost recovery: We will continue establishing rates for Power and Transmission Services so that the forecast of total accrued revenues is at least equal to the forecast of total accrued expenses to have at least a neutral effect on

cash flow. We will continue to explore options to address periods when cash inflow exceeds annual repayment needs.

STAKEHOLDERS INVITED TO REVIEW PROGRAM LEVELS

In years past, we had conducted separate public processes on our proposed spending levels for transmission, power and capital programs before incorporating those costs into rate case proposals. Previous forums included the Power Function Review, Programs in Review and the Capital Planning Review.

Our customers asked us to consolidate these processes and allow comprehensive review of all of our proposed costs in one public venue. This led to creation of the Integrated Program Review, which began in May. It and the previous processes are part of our commitment to financial transparency.

BPA expects to conduct this review every other year before preparing for power and transmission rate cases. This will give our customers and constituents a chance to review our proposed costs before those costs are put into power and transmission rates.

In its first iteration, the Integrated Program Review covered:

- Power expenses for 2009. We reset our 2009 power rates in response to a 2007 ruling by the U.S. Court of Appeals for the Ninth Circuit on Residential Exchange Settlement Agreements;
- Expenses for power and transmission functions in 2010–2011;
- Capital programs through 2013.

After carefully considering the comments in the review, we adjusted our 2009 expense forecast down by approximately \$8 million

from the initial IPR proposal for 2009 expenses to be paid through power rates. The forecast of capital expenditures was reduced by \$10 million. However, because the capital reduction is reflected in depreciation and interest, there is not a corollary reduction in the revenue requirement. Changes to depreciation and interest amounts as a result of capital reductions are determined in rate cases.

RATE CASE SET FOR 2010–2011

BPA power and transmission rates are moving to the same cycle in 2010–2011 for the first time in more than a decade. A single rate case will contain separate dockets for power and transmission. This will simplify administration and reduce process time and cost for the agency and interested parties.

POWER

POWER RATES STAYED STEADY

2008 was the second year of a three-year power rate period. The rate case established fixed rates for the period with the possibility of a Cost Recovery Adjustment Clause, a Dividend Distribution Clause, a Biological Opinion Adjustment (NFB Adjustment)³ or an Emergency NFB Surcharge in each of the years. None of these additional rate-related clauses triggered, and BPA's Priority Firm (PF) power rate remained the same as in 2007.

CONTRACTS TO CONCLUDE HISTORIC DIALOGUE

Since 2002, we have been engaged in a Regional Dialogue with our customers and other stakeholders to determine BPA's long-

term power role in the Pacific Northwest and to ensure the region has adequate power supplies well into the future.

This dialogue will culminate with long-term power sales contracts and a new tiered rates methodology. Developing these has been our highest priority this year. In August, we rolled out the final version of the first of our new 20-year contract templates.

Our standardized contract templates pave the way for power sales contracts covering 2012–2028. From September through November, we will be working with our utility customers on individual contracts by filling in the customer-specific information. We expect to sign the final contracts on Dec. 1, 2008.

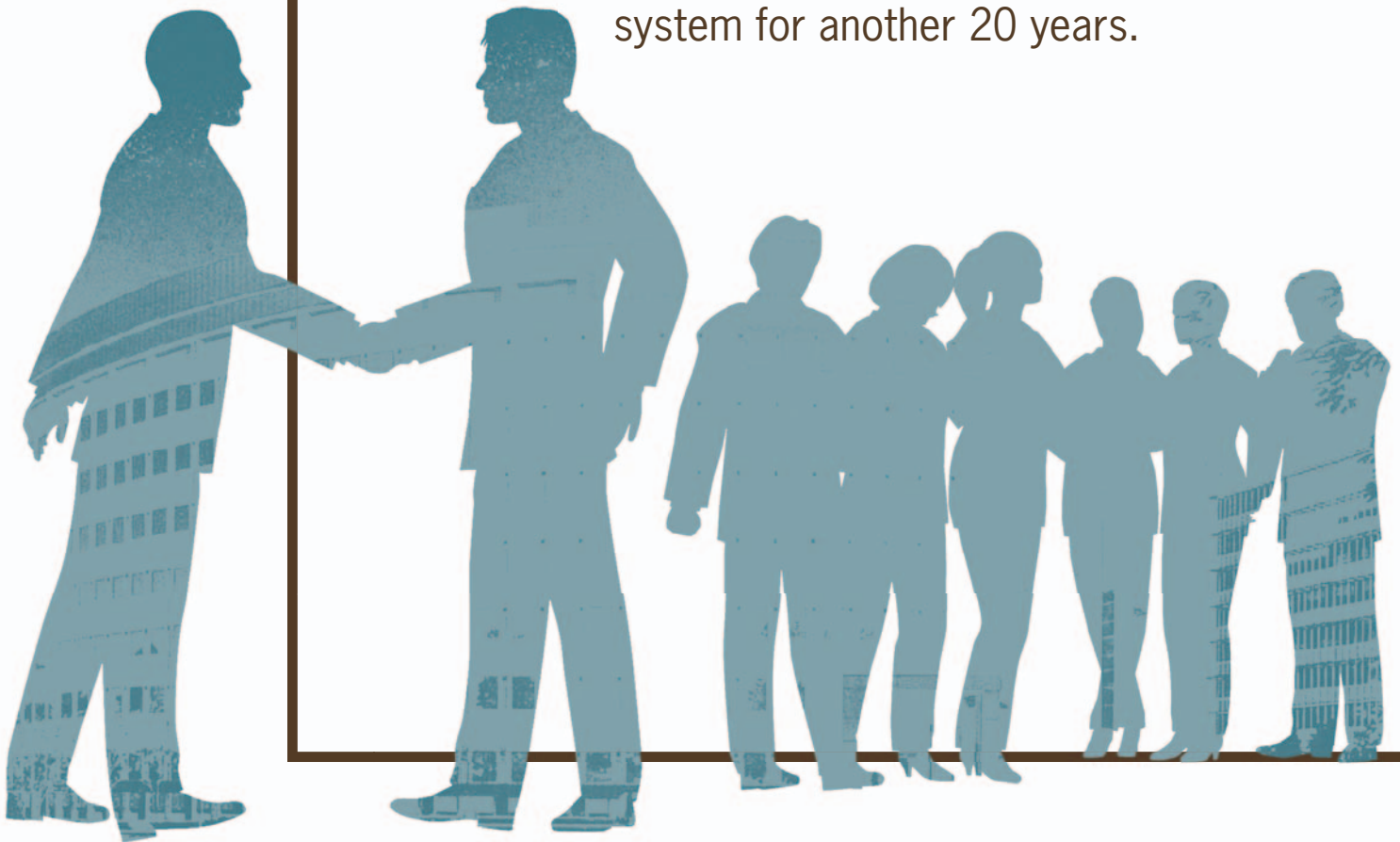
In August, we rolled out our new 20-year contract templates.

TIERED RATES TO BE THE FUTURE

Tiered rates will be a key element of the new long-term Regional Dialogue contracts, and we completed development of a Tiered Rate Methodology in fall 2008. The methodology will establish a predictable means for tiering PF preference power rates beginning in 2012. We believe the new tiered rate structure will promote conservation and the efficient use of resources to meet future load growth.

CONTRACTS WILL ESTABLISH ROLES IN 20-YEAR PARTNERSHIPS

We are offering contracts well ahead of the time that current contracts expire (2011), so that both we and our utility customers will know well in advance who has responsibility to develop new resources to meet load growth starting in 2012. Having this certainty in advance will help ensure that new resources are in place when they are needed. Also, by signing these contracts, customers secure the benefits of a defined amount of low cost-based power from the federal system for another 20 years.



A tiered structure means that, beginning in 2012, we will limit our sale of firm power to Northwest consumer-owned utilities at our lowest Priority Firm rates to approximately the firm capability of the existing federal system with limited augmentation. Those sales will be to preference customers⁴ at Tier 1 rates to meet their regional firm requirements loads.

Customers will have choices about how they will meet their need for power beyond what they can purchase at Tier 1 prices.⁵ They can opt for nonfederal resources that they acquire to serve their loads or for augmented BPA power at Tier 2 rates. Tier 2 rates will be set to cover the costs of acquiring power beyond that supplied by the existing federal system.

The Tiered Rate Methodology is a rate design and does not set rate levels, which will be determined in rate cases during the term of the methodology through 2028.

METHODOLOGY REVISED FOR RESIDENTIAL EXCHANGE

In May 2007, the U.S. Court of Appeals for the Ninth Circuit held that Residential Exchange Settlement Agreements BPA reached in 2000 with investor-owned utilities were not consistent with the Northwest Power Act. This past year, we spent a substantial amount of time working with our customers and other interested parties to comply with the court's decision and re-establish the Residential Exchange Program beginning in 2009.

In late June, after an extensive public process, BPA issued a new Average System Cost Methodology as part of this larger effort. Determining a utility's average system cost is essential to determining the level of

exchange benefits a utility's residential and small-farm consumers will receive.

The purpose of the Residential Exchange Program is to give Northwest residential and small-farm consumers a form of access to federal power, whether they are served by consumer- or investor-owned utilities. Exchange benefits must be passed on to these consumers. Traditionally, most exchanging utilities have been investor-owned because their average system costs tend to be higher.

Customers will have choices
about how they will meet their
need for power.

We believe the new 2008 Average System Cost Methodology is not only consistent with the Northwest Power Act but also is a much more transparent methodology than the previous 1984 methodology and better reflects the realities of the current utility world. It should provide shorter and less contentious ASC determinations while also aligning the ASCs used in power rates with those used to determine actual exchange benefits.

RESIDENTIAL EXCHANGE PROGRAM RE-ESTABLISHED

Parallel with development of a new Average System Cost Methodology, we also conducted the 2007 Supplemental Wholesale Power Rate Case. This rate case re-opened—

We used the Northwest Power Act as our foundation to rebuild a Residential Exchange Program.

or supplemented — the wholesale power (WP-07) rate case concluded in 2006. This allowed us to respond to the Ninth Circuit Court's 2007 rulings related to the 2000 Residential Exchange Settlement Agreements and BPA's 2002 power rates.

In September, we issued a record of decision resulting from the WP-07 Supplemental Rate Case. This responded to the REP settlement-related and ratemaking issues addressed by the court. It also established the PF exchange rates to be used in the re-established REP beginning in 2009. In addition, it will lower wholesale power rates for consumer-owned utilities by 1 percent for 2009. Finally, it initiated the return of past overcharges to these utilities.

Total exchange benefits to be provided utilities' residential and small-farm customers in fiscal year 2009 are about \$180 million. Total payment to certain preference customers is about \$257 million, which reflects overcharges for 2007 and 2008. An additional \$155 million will be distributed as credits on qualifying preference customers' bills in 2009. This is the first of a total of \$767 million in past overcharges that BPA plans to recover from investor-owned utilities and return to qualifying preference customers.

We used the Northwest Power Act as our foundation to rebuild a Residential Exchange Program that we believe will be legally sustainable going forward.

INTERIM AGREEMENTS PAYMENTS MADE

As a result of the Ninth Circuit Court's 2007 ruling, BPA stopped payments under the Residential Exchange Settlement Agreements. Recognizing that it would take more than a year to resolve the complex residential exchange issues, BPA offered both consumer-owned and investor-owned utilities agreements under which they could receive interim payments, subject to a later true-up. In April, interim payments of \$171 million and \$110 million were provided to consumer-owned and investor-owned utilities, respectively.

BPA paid the difference between interim payments and amounts due to the consumer-owned utilities in October, and expects to pay the difference to investor-owned utilities once all legal challenges are resolved.

WIND RESOURCE PURCHASED

In October 2007, BPA signed a 20-year agreement to purchase 50 megawatts of wind capacity from the new Klondike Wind Power III project under a contract with Iberdrola Renewables (then called PPM Energy). This wind purchase is cost-competitive, and it fits with our mission to ensure an efficient and economic power supply. BPA has purchased more than 270 megawatts of long-term wind power since 1999.

This purchase will help us meet our load obligations. Given that wind power is an intermittent resource, that capacity should

translate to about 15 average megawatts. Additionally, the Klondike III acquisition will serve the growing demand for renewable resources in the region, spurred by legislation in Washington, Oregon and Montana that requires many BPA customers to phase in additional renewable energy resources over time.

Electricity from Klondike III was integrated into BPA's system in late 2007 and is being sold as Environmentally Preferred Power⁶ or as Renewable Energy Certificates. Renewable Energy Certificates, also known as green tags, represent the "greenness" or environmental attributes of one megawatt-hour of electricity generated from renewable sources.

RESOURCE PROGRAM DEFERRED

In February, we invited customers and the public to participate in developing our 2008 draft Resource Program. The Resource Program is intended to help assure that future resource acquisitions best meet the agency's statutory and contractual obligations and strategic objectives.

The Resource Program had been scheduled for public review in December 2008. However, under a new schedule, the draft likely will be issued in July 2009 for public review and finalized in October 2009. The new schedule allows the region to focus on completing Regional Dialogue contracts. It also better synchronizes our Resource Program process and analysis with the Northwest Power and Conservation Council's⁷ Sixth Power Plan, enabling the Resource Program to rely more on the Council's public process and resulting assumptions and analyses.

FORUM ANALYZES HYDRO PERFORMANCE

Last spring, we asked for bids on a project to help the Pacific Northwest Regional Adequacy Forum perform a sustained hydro peaking capacity analysis that includes a review of the entire region's hydro system. The forum is yet another example of collaboration. It is made up of regional utility experts and policy makers and is co-sponsored by BPA and the Council.

The project involves collecting analyses from each regional utility on sustained hydro peaking capacity and performing analyses for those utilities that do not do resource plans. This information will help us better understand how the Northwest hydro system performs in meeting peak loads and non-power obligations under challenging conditions such as droughts and/or winter cold snaps and summer heat spells.

Growth in peak loads, the need to limit hydro generation at certain times to support fish passage and the expansion of wind generation in the region are combining to put greater stress on the hydro system. We are planning for these critical times now,

BPA has purchased more than 270 megawatts of long-term wind power.

because securing additional power resources or implementing demand-side management programs both take time. The Council is working on its Sixth Power Plan, which will be a primary vehicle for the planning effort, in concert with the plans of individual utilities.

TRANSMISSION QUEUE MANAGEMENT IMPROVED

As the year opened, BPA's queue for network transmission requests had grown to a size that made it difficult if not impossible to manage. There were about 230 individual requests for new long-term firm transmission capacity representing thousands of megawatts. At times, the total requests exceeded 12,000 megawatts.

Under our first-come, first-served queue, it was difficult to determine which parties requesting transmission were able or willing

to commit immediately and which were simply attempting to hold a place in the queue to reserve transmission capacity for projects that may or may not be built.

To resolve these issues, BPA's Transmission Services came up with an innovative solution, launching its first Network Open Season in mid-April. Parties wishing to secure long-term firm capacity on our network transmission system were asked to sign "precedent agreements," which committed them to take service at a specified time and under specified terms.

The customer response exceeded our expectations with 28 customers signing 153 agreements representing 6,410 megawatts. They also put up more than \$83 million in security deposits. Wind project interconnection requests made up 74 percent of the total (4,716 megawatts). Given that there are now about 1,500 megawatts of wind currently on our system and a total of approximately 3,000 megawatts expected by the end of calendar year 2009, we are accelerating our efforts to tackle issues related to integrating large amounts of wind in the region.

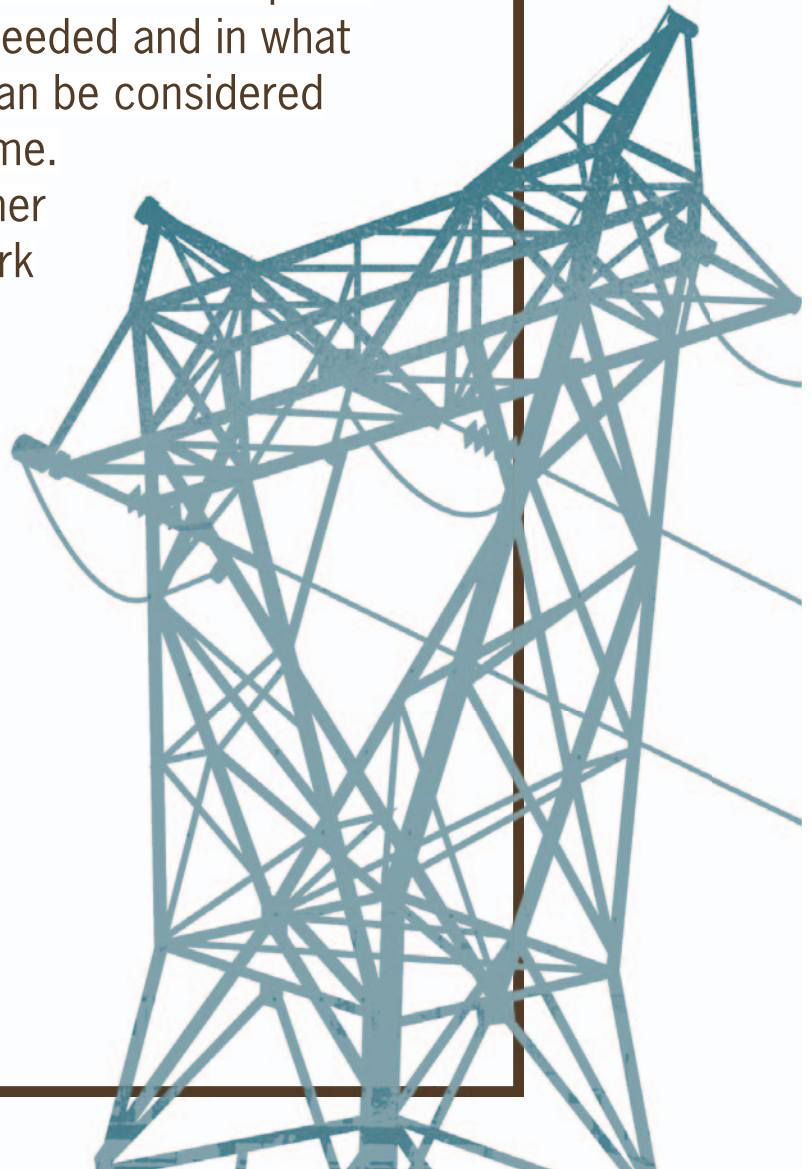
We were particularly pleased with the support and interest from the Federal Energy Regulatory Commission. In comments on its declaratory order related to Network Open Season, FERC Commissioner Suede Kelly noted, "In the last few years we have seen unprecedented demand for new generation, particularly renewable generation, which is taxing the interconnection queue system. This has resulted in delays in bringing generation, including renewables, on line. BPA took the bull by the horns in meeting its queuing challenges, by developing an innovative network open season ..."

**“BPA took the bull by the horns
in meeting its queuing challenges,
by developing an innovative
network open season ...”**

FERC Commissioner Suede Kelly

OPEN SEASON HELPS DETERMINE WHERE TRANSMISSION IS NEEDED

Open seasons and cluster studies provide benefits for both BPA and customers. With defined open season windows, customers can submit long-term firm transmission service requests that are consistent with their resource timing and needs. This helps us determine where services are needed and in what quantity because all requests can be considered together rather than one at a time. Conducting cluster studies, rather than individual studies of network transmission requests, allows planners to better see integrated system needs. And BPA can focus its attention on the system constraints and priorities that will require the most work.



Regional transmission coordination is key to sustaining reliability as loads continue to grow.

CLUSTER STUDIES DETERMINE INFRASTRUCTURE NEEDS

Now that precedent agreements have been signed, we are conducting “cluster studies” of the requests to determine how much transfer capability can be offered from the existing system and which new transmission facilities, if any, will be required to accommodate the requests. We expect that new infrastructure will be needed.

CONGESTION MANAGEMENT PILOTS TESTED

For the second year in a row, we conducted pilot projects to help relieve congestion on our existing transmission system. This year, Transmission Services launched a reliability redispatch pilot and a curtailment calculator prototype to test cost-effective solutions for managing constraints. Both these pilots will run through the end of September 2009.

Reliability redispatch relieves congestion when specific generators adjust their generation output. We can pair different generators’ increases and decreases in output and thereby relieve congestion across affected bottlenecks or flowgates.⁸ The new redispatch pilot has been expanded from the previous summer’s effort to include

participants outside BPA’s balancing authority.⁹ It also includes all 10 of BPA’s internal network flowgates. This will increase participation and give us the ability to use this tool to solve congestion problems instead of having to curtail transmission.

The curtailment calculator prototype will allow BPA to curtail transmission schedules at each affected flowgate consistent with the tariff. The previous year, we could either use reliability redispatch or curtailment calculators within a given hour. For this pilot, both tools can be used within the same hour.

Several other improvements recommended by participants in the 2007 pilot have been made to the bidding and settlement process, including how we settle generation imbalance charges.

UTILITIES COLLABORATE THROUGH COLUMBIAGRID

BPA believes regional transmission coordination is key to sustaining reliability as loads and commercial use continue to grow. BPA belongs to ColumbiaGrid, an independent regional transmission organization, along with Avista, Chelan County Public Utility District, Grant County Public Utility District, Puget Sound Energy, Seattle City Light and Tacoma Power. ColumbiaGrid can help the region achieve timely construction of needed infrastructure, increased efficiency in grid use and sustained grid reliability.

ColumbiaGrid has issued functional agreements to develop its services in regional transmission planning and expansion, reliability and a common ColumbiaGrid OASIS.¹⁰

“ENERGY HAS NO BORDERS”

In April, Western electric utility leaders, including the BPA administrator, sent an open letter to governors, regulators, legislators and key policymakers throughout the Western states. The letter called for a collaborative approach to addressing current challenges, including climate change policy, siting and construction of transmission to integrate renewable resources and other policy decisions that will shape the future of energy in the West.

“Our western electric grid is fully interconnected, and changes in policy, resource additions and operations affect us all,” the Western leaders said. “Energy has no borders. Utilities in the West share many of the same concerns and have been working cooperatively for decades ... We intend to strengthen our efforts to work together to find solutions to the common challenges affecting rates, reliability and a sustainable energy future.”



In addition to ColumbiaGrid members, the Cowlitz and Snohomish public utility districts participate in these agreements.

This year, ColumbiaGrid coordinated regional review of BPA's West of McNary and I-5 Corridor upgrade projects. Both projects received Western Electricity Coordinating Council approval in March. In April, ColumbiaGrid issued an assessment of participants' transmission systems. An expansion plan is due in December 2008. ColumbiaGrid also coordinates members' responses to FERC orders relating to regional planning.

The improvements will allow more electricity to be moved both ways between Oregon and California.

ColumbiaGrid is developing common business practices for its members to support a common OASIS transmission reservation site. These business practices include an Available Transfer Capability methodology and common queues for transmission and generation integration requests.

ColumbiaGrid is facilitating a joint initiative with the Northern Tier Transmission Group and WestConnect on multi-control area solutions for operating challenges associated with the rapid growth of intermittent resources such as wind.

INTERTIE IMPROVEMENTS PLANNED

BPA and Northwest co-owners of the California-Oregon Intertie transmission system are planning to upgrade several COI facilities. The upgrades are designed to reduce current operational constraints, increase the quality of service and boost overall system reliability and sales.

Interties are high-voltage systems that carry power between regions, such as the Northwest and Southwest. Both regions benefit from this conduit. The COI has opened up Western markets, has helped avert potential power shortages and has reduced the need to build new power plants in each region.

The improvements will optimize the COI's current transfer capability of 4,800 megawatts, which will allow more electricity to be moved both ways between Oregon and California and will meet some of California's growing needs when excess energy is available from the Northwest. While we own the majority of transmission capacity on the system, we also have been working with the other COI owners — Portland General Electric, PacifiCorp and others — to fund the proposed improvements.

Along with more effective curtailment management on the BPA network, this project will allow BPA to make additional long-term sales on the COI. In addition, because the operations of the COI and the Pacific Direct Current Intertie are complementary, this project also will enable BPA to make additional sales on the PDCI.

LEASE FINANCING HELPS INFRASTRUCTURE

Historically, BPA has borrowed funds from the U.S. Treasury to expand and upgrade its transmission infrastructure. However, as BPA approaches its legislatively prescribed limit for that borrowing authority, we have sought other methods of funding projects.

The Lease Financing Program is an effort to use more third-party financing to upgrade or construct transmission facilities, which will help us preserve the amount of money we can borrow from the Treasury for infrastructure and other projects. Given the amount and scope of work needed on our aging transmission system, we would expect to hit our statutory borrowing limit with Treasury some time between 2013 and 2015 if we were to rely exclusively on Treasury borrowing for projects. The Lease Financing Program will extend this period by four to five years.

WIND PRESENTS OPPORTUNITY/CHALLENGES

BPA now has 1,500 megawatts of wind power in its transmission grid, just 10 years after the first 25-megawatt commercial wind project came on line in its system. Projections suggest wind's fast growth is just beginning. We expect to have 3,000 megawatts of wind power on our system by the end of 2009, and could have 6,000 megawatts in our balancing authority by 2013. Potential customers, representing more than 4,700 megawatts of wind, signed service agreements with BPA this summer under the Network Open Season.

Because so much wind is locating in the BPA system so quickly, BPA is putting a

high priority on resolving technical issues associated with high concentrations of variable wind power in its load/resource balancing authority.

WIND BALANCING SERVICE RATE ADOPTED

Because wind power output can vary moment-to-moment, BPA has to adjust power produced from other sources to respond to the variable wind output so that loads and generation remain balanced. This "balancing service" has a cost.

During 2008, BPA conducted and settled a 2009 Wind Integration Within-Hour Balancing Service Rate Case, with the rate going into effect Oct. 1, 2008. Under the settlement rate of 68 cents per kilowatt per month for 2009, BPA will recover 2009 costs of within-hour balancing for wind primarily from the parties that create the costs.

This settlement supports both wind power development and appropriate allocation of wind integration costs. At the same time, it lets the region's wind integration experts focus their time and attention on solving the long-term technical

We expect to have 3,000 megawatts of wind power on our system by the end of 2009.

BPA SUPPORTS NORTHWEST WIND POWER

BPA provides physical interconnection and transmission integration services for all the wind farms (and other resources) in our balancing authority. To date, we have built five substations and six tap lines to interconnect 19 wind projects to our transmission grid. More interconnection projects are planned or in progress.

Wind is a valuable resource that, because of its variability and the location of wind farms away from load centers, presents significant technical and operational challenges. Through an interdisciplinary Wind Integration Team and in collaboration with wind power developers, Northwest utilities, public interest groups and others, we are working to develop better tools to cost-effectively manage the large amounts of wind power entering the Northwest grid.

issues of integrating large amounts of wind generation in the Northwest grid.

In accordance with the WI-09 Wind Integration Within-Hour Balancing Service Rate Case, we also are working to refine our reserves forecasting methodology to accommodate higher levels of wind integration and changing systems operations within our balancing authority. This methodology will be the basis for estimating the quantity of within-hour reserve needs for Transmission Services' initial rate proposal for 2010–2011.

FERC TARIFF 890 FILING MADE

BPA made an Order 890 filing with the Federal Energy Regulatory Commission on Oct. 3, 2008. This filing responds to FERC's February 2007 order modifying its pro forma transmission tariff and making a number of changes designed to ensure non-discriminatory open access to transmission service. BPA's filing did not address Schedule 9 of the pro forma tariff, which could bind BPA to provide a generation imbalance service for wind integration in quantities BPA is not sure it could provide. The agency will respond separately on Schedule 9 and is working with the region's utilities, wind developers and other interested parties to resolve this issue.

WECC DIRECTIVE COMPLETED

On June 28, a tree came into contact with BPA's Big Eddy-Chemawa 230-kilovolt line, near Salem, Ore. We self-reported the incident to the Western Electricity Coordinating Council, and WECC issued a Remedial Action Directive to BPA on July 3. It called for a comprehensive inspection of all 8,500 miles (approximately 15,000 circuit

miles) of BPA transmission rights-of-way within 90 days.

We rigorously complied with WECC's directive and took aggressive measures to identify and remove vegetation threats along all our rights-of-way to ensure we are in strict compliance with all vegetation standards systemwide.

We are working to develop better tools to cost-effectively manage large amounts of wind power.

The inspection involved land crews walking or driving all lines, aerial inspections and a review of digital photos by several levels of management to certify the rights-of-way were free of vegetation. Despite the extent and ruggedness of terrain involved, we completed the inspection more than a month before the deadline.

We remain committed to using the lessons learned from this incident and the subsequent patrol and certification of our rights-of-way to modify our practices and policies to strengthen our vegetation management program.

FISH & WILDLIFE FISH RUNS SHOW UPSWING

We are encouraged not just by the increasing strength of salmon runs but by the diversity of species for which we see

improving trends. Snake River stocks in particular made gains in 2008. Both fall chinook and sockeye runs to Lower Granite Dam were the highest since counts began in 1975. More than 550 endangered Snake River sockeye returned to their spawning area in Idaho's Stanley Basin — the largest return to the spawning area in decades.

Across the Columbia Basin, by the end of September, steelhead, coho and sockeye returns at Bonneville Dam had surpassed the previous 10-year average. Sockeye returns were four times higher than the 10-year average. Only Willamette Basin adult salmon returns were substantially below average.

Although the reasons for the good returns are complex and not fully understood, recent improvements to the hydroelectric dams on the Snake and Columbia rivers are credited in part with increased survival of juvenile salmon heading downstream to the Pacific Ocean. It's important to note that the increasing runs in the Columbia Basin came at the same time when salmon runs throughout the rest of the West Coast were depressed. This supports the conclusion that federal efforts in the Columbia Basin are producing results.

We continue to believe there is no one solution to salmon recovery. We are committed to multiple strategies that improve salmon habitat, address the role of hatcheries and include hydro system improvements.

COLUMBIA BASIN FISH ACCORDS FORGED

May 2 was a landmark day in the Pacific Northwest. On that day, representatives of the federal government, including BPA, and Columbia Basin tribes signed a deerskin at a historical tribal village and fishing site on the Columbia River, creating the Columbia Basin Fish Accords.

Under the Accords, federal agencies, primarily BPA, will provide approximately \$933 million¹¹ over 10 years, enabling the tribes and states to continue existing programs and to implement new priority fish projects. In return, the tribes and states committed to achieving biological objectives linked to meeting the federal agencies' statutory requirements. They also agreed that the Accords would specifically resolve, for these parties, pending Endangered Species Act litigation.

Tribal participants to date include the Yakama Nation and the Umatilla, Warm Springs, Colville and Shoshone-Bannock tribes. The Columbia River Inter-Tribal Fish Commission also was a signatory. The states of Idaho and Montana also signed agreements with the federal agencies: BPA, the U.S. Army Corps of Engineers and the Bureau of Reclamation.

The Accords also recognize and use the tribes' science and resource management expertise. The tribes gain funding stability and certainty for 10 years. This will allow

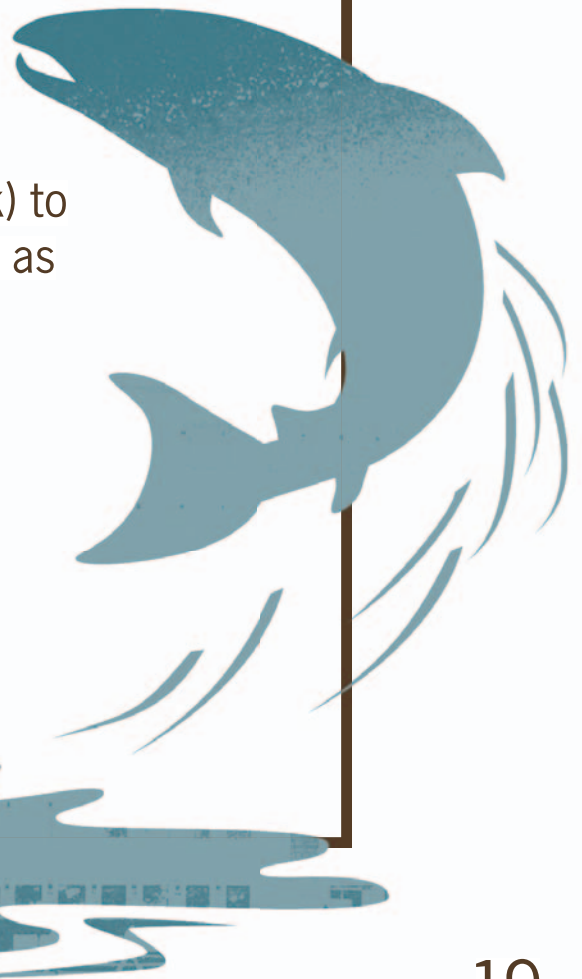
Federal efforts in the Columbia Basin are producing results.

ACCORDS LAUNCH ERA OF COLLABORATION FOR FISH

Columbia Basin Fish Accords signed in May 2008 establish a new relationship among participating Northwest tribes, federal agencies and states. This is a historic step toward ending 30 years of divisiveness and ushering in a new era of collaborative efforts on behalf of the Columbia Basin's fish, including endangered species.

The Accords offer a number of benefits. There is a far better chance of achieving tangible benefits when the parties work in partnership.

The agreements take a holistic ecosystem approach providing for enhanced funding and activities (new projects and expansions of existing work) to benefit both listed and non-listed stocks, as well as key species that are not salmon, including sturgeon and lamprey.



BPA has protected more than 300,000 acres of habitat.

them to focus on implementation and to reduce administrative costs.

LAND ACQUISITIONS HELP WILDLIFE

Dams have affected wildlife as well as fish. A number of tribes, as well as state fish and wildlife agencies and the U.S. Fish and Wildlife Service, have worked out agreements with BPA to define the long-term management and protection of these affected areas. The list of habitats they preserve is extensive. It includes moose, white-tailed deer, elk, mule deer, blue grouse, waterfowl, raptors and numerous small game species. Habitat acquisitions funded by BPA also protect fish such as bull trout, which are listed as threatened, and westslope cutthroat trout. Many varieties of trees and shrubs are also protected by these agreements.

In 2008, we funded the purchase of more than 4,500 acres, which will be managed by other parties to provide long-lasting benefits for numerous species. All together, BPA has protected more than 300,000 acres of habitat in the Northwest since 1980. BPA receives credits for the units of habitat that it protects and enhances. These credits apply against a ledger that describes net habitat lost or damaged as a result of federal dams.

NEW BIOLOGICAL OPINION RELEASED

On May 5, NOAA Fisheries Service¹² released a 2008 final biological opinion for operation of the Federal Columbia River Power System. The new biological opinion includes more specific actions in habitat than ever before, quicker and safer passage for juvenile fish past the dams and a comprehensive review of all 186 hatchery programs in the Columbia Basin. This review is intended to ensure that hatcheries do not impede recovery of salmon and steelhead that are listed under the Endangered Species Act. The plan also calls for the federal hydro system to meet higher standards for juvenile fish survival through the dams than ever before.

The most significant difference is the overall rigor and scope of the scientific analysis that provided the foundation for the actions in the plan. The plan also reflects unprecedented coordination, which helped lay the foundation for the Columbia Basin Fish Accords with Northwest tribes and states. The opinion concluded that the actions BPA, the Corps of Engineers and Bureau of Reclamation planned to carry out would put threatened and endangered Columbia Basin salmon and steelhead on a trend to recovery.

NOAA Fisheries issued three additional biological opinions — one for the Upper Snake irrigation dams operated by Reclamation, one for Columbia Basin harvest and one for the Willamette Basin. All are based on a single comprehensive biological analysis so that conservation efforts for salmon take all actions into consideration.

LITIGATION CONTINUES

For years, biological opinions issued by NOAA Fisheries have been the subject of litigation filed principally by environmental and fishing groups. The biological opinions govern how BPA, the Corps and Reclamation will work to protect and recover threatened or endangered species affected by construction and operation of federal dams.

Judge James Redden of the U.S. District Court of Oregon had remanded previous biological opinions to NOAA, directing the federal agencies to collaborate with federal, state and tribal governments to deliver a new opinion that addressed the concerns of the court.

After the May biological opinion was issued, environmental and fishing groups again filed suit in June against NOAA Fisheries charging that it ignored the best available science and that the plan is not substantially different from previous plans. They and the state of Oregon sought a separate science review.

In a late August hearing before Judge Redden, the U.S. Department of Justice noted that the plan has benefited from both independent science review and extensive collaboration from a variety of stakeholders in the region. Many of these stakeholders — tribes and states, plus other regional interests — spoke before the judge in support of the new biological opinion. They underscored the collaborative discussions and more than 200 meetings that have taken place in a two-year process aimed at finding areas of commonality and agreement.

This fall, parties to the litigation are expected to complete their filing of motions for injunction or summary judgment.

ENVIRONMENT LONG-TERM PCB CLEANUP COMPLETED

This summer marked the completion of BPA's Polychlorinated BiPhenyls Capacitor Replacement Program. The program grew out of a Memorandum of Agreement we signed with the Environmental Protection Agency in 1985. In the Memorandum of Agreement, we committed to conduct a planned and organized approach to toxic waste cleanup.

Since 1991, we have replaced more than 100,000 capacitors containing PCB on our transmission system at a cost of approximately \$102 million. The last replacement was completed in August. The MOA did not specifically mention capacitors, but BPA took the additional step of not returning PCB capacitors to a yard that had been cleaned up. This is in line with our vision and core values of responsible environmental stewardship.

In 2007, BPA was acknowledged for its participation in the Environmental Protection Agency's Voluntary Accelerated Removal Program for PCB.

Since 1991, we have replaced more than 100,000 capacitors containing PCB on our transmission system.

BPA will report its 2009 greenhouse gas emissions to The Climate Registry.

BPA PARTICIPATES IN WREGIS

To encourage development of renewable resources, BPA is participating in the Western Electricity Coordinating Council's Western Renewable Energy Generation Information System as a registered Qualified Reporting Entity for projects that generate renewable energy in our balancing authority.

WREGIS was developed in response to policies set by the California legislature and the Western Governors' Association to develop and implement a system to track renewable energy generation. It is an independent, renewable energy database that creates and tracks renewable energy certificates from projects that register in the database. The system, which is the largest of its kind in the world in terms of coverage, includes the Western Interconnection.

Through WREGIS, BPA is offering a free generation reporting service to qualifying renewable resource generators in its service area. This will allow qualifying wind, biomass, geothermal and other qualifying generators in our balancing authority to receive Renewable Energy Certificates from WREGIS for their output, which will foster renewable resource development. Utilities can use the WREGIS verification to

demonstrate compliance with state renewable portfolio standards.

In June, we began amending our existing contracts for sale of Environmentally Preferred Power to allow tracking of renewable energy attributes associated with Environmentally Preferred Power under the WREGIS.

CLIMATE CHANGE TAKES MULTI-FACETED APPROACH

"Responsible environmental stewardship" is an integral part of BPA's vision statement. In keeping with this vision, our 2008 Strategic Plan included this objective for the first time: "BPA encourages and implements integrated, cost-effective policies which lead to greenhouse gas emission reductions." Here are some steps we are taking.

Developing a Climate Change Action Plan.

This plan will put us on track to preserve our valuable low-emission resources, make sure our operations plans and energy efficiency targets adequately consider potential greenhouse gas restrictions and serve customer needs related to new climate-related initiatives, such as renewable portfolio standards.

Growing greener from the inside out.

We are working to comply with Executive Order 13423, which seeks to strengthen federal environmental, energy and transportation management. We are establishing ways to reduce our electricity, water and petroleum use, including purchasing alternative fuel vehicles, adopting LEED¹³ Gold standards for new buildings and upgrading the energy efficiency of lighting. As part of the

HELPING DEFINE GREENHOUSE GAS REPORTING PROTOCOLS

On May 1, 2008, BPA signed a letter of intent to report its 2009 greenhouse gas emissions to The Climate Registry. In doing so, we became a “founding reporter” of this nonprofit greenhouse gas reporting organization, which is supported by 39 member states, seven Canadian provinces, five Mexican states (those bordering the United States) and three tribes. Our initiative to conduct a formal greenhouse gas emissions inventory reflects a commitment to better understand our own environmental footprint.

Our participation signals our intent to help define greenhouse gas reporting protocols for the electricity sector. This will support societal efforts to reduce greenhouse gas emissions and support our customers who are — or will be — subject to mandatory greenhouse gas reporting.



The Northwest set a record for gains in electric power efficiency.

Department of Energy, we are committed to meet the goals of this order consistent with sound business practices.

Studying potential physical impacts of climate change in the region. We are working with the University of Washington and the Council to better understand potential impacts of climate change on precipitation, streamflows and snowpack.

Investing in research and development. We are funding a number of research projects related to climate change, from understanding potential future Columbia River flows to integrating wind energy to estimating wave and tidal resources.

ENERGY EFFICIENCY NORTHWEST SEES RECORD ENERGY SAVINGS

This was a banner year for both BPA's and the region's energy efficiency efforts. In partnership with our customers, we captured over 76 average megawatts of new conservation savings, which translates to the equivalent power consumption of about 65,000 households in the Pacific Northwest.

We exceeded our energy efficiency targets for the year in two ways. First, the captured savings significantly exceed the

targeted savings for the year of 52 average megawatts. Second, the targeted average cost per average megawatt was a range of between \$1.4 million and \$1.5 million, but the savings came in at under \$1 million.

Regional savings overall continue to be impressive. In 2007 — the most recent year for which final figures are available — the Northwest set a record for gains in electric power efficiency. The Northwest Power and Conservation Council reported that the year's energy conservation achievement amounted to reduced electricity use of 200 average megawatts, or 1,750 million kilowatt-hours. This is the equivalent of enough electricity for approximately 146,000 Northwest homes. It also meets about half of the typical annual growth in electricity use in the Northwest.

The record gain in 2007 added to the region's total energy efficiency achievement since 1978, which now stands at 3,700 average megawatts. As electricity generation, that would be more than enough power to supply all of Idaho and western Montana combined. A significant portion of the energy savings comes from BPA programs and BPA customer programs.

BPA offers incentives to its customers and also is a major contributor to the Northwest Energy Efficiency Alliance. The alliance is working to improve national energy efficiency standards for major appliances and is working with state and federal governments, which are implementing codes with stronger energy efficiency requirements.

The 2007 survey included results from more than 80 electric utilities collectively representing 86 percent of the region's

electricity demand. The largest savings were in the residential sector, and the largest contribution to that savings — 60 percent of the residential savings — came from compact fluorescent light bulbs.

CFL CAMPAIGN IS SUCCESSFUL

More Northwest consumers are using compact fluorescent lights these days, thanks in part to a Change-a-Light Twister promotion supported by BPA. During the promotion, which ran from September 2007 to February 2008, participating retail outlets throughout the Northwest sold more than 2,200,000 CFLs for less than \$1 each. Compared to traditional incandescent lighting, that number of CFLs equates to almost eight average megawatts of energy savings.

As a result of this regional promotion, 54 participating utilities received a credit from BPA on their energy bills. Utilities received \$2.50 for each bulb sold in their service territories. Many utilities ran advertisements or bill inserts to let their customers know about the promotion.

Promotions such as this are part of BPA's strategy to change markets where there is the potential to save energy. Lighting has been identified as one of the major sources of energy savings in both residential and commercial market sectors.

NEW EFFORTS CONTINUE TO BE AGGRESSIVE

In 2009, we plan to conduct a public process on the future role of BPA regarding energy efficiency post-2011.

Load management and Smart Grid are two primary areas of focus. These range from automatic meter reading to real-time

communication of electricity use/price to the end-use consumer. Smart Grid is a new, broad term that can encompass activities ranging from power generation to distribution to end-use customers.

PARTNERSHIPS PROMOTE ENERGY EFFICIENCY

To ensure the momentum for efficiency continues, several Pacific Northwest leaders inside and outside the utility industry formed the Northwest Energy Efficiency Taskforce in 2008. It is a volunteer group whose aim is to further improve the efficient use of electricity throughout the region.

The taskforce is exploring how, through regional collaboration, energy efficiency can be delivered more efficiently.

The BPA administrator along with PacifiCorp's president and the Northwest Power and Conservation Council's past chair are co-leads of the taskforce. The group's executive committee includes more than 25 senior representatives of regional utilities, state governments, customers, industry and energy efficiency experts.

The taskforce is pulling together innovative ideas from successful energy efficiency and demand-side management programs and exploring how, through regional collaboration, energy efficiency can

ENGAGING CONSUMERS IN ENERGY EFFICIENCY

The Northwest Energy Efficiency Taskforce launched this year recognized at its first meeting that energy efficiency offers utilities a unique opportunity to connect with their end-use consumers on a new level. Consumers' priorities have changed over the last few years. They are better informed about environmental issues, but they need and expect help from the utilities.

Putting a greater emphasis on the consumer will be one of the key ways the region can improve on its energy efficiency accomplishments. We will help our customers design products that are easy to use, accessible and responsive, while keeping the consumer in mind. The taskforce will release draft recommendations from its work groups in January 2009.



be delivered more efficiently. Technical work groups are undertaking the following tasks:

- Reviewing energy efficiency best practices and elements of highly successful energy efficiency programs;
- Analyzing state energy efficiency incentives;
- Researching how consumers' use of electricity has changed over time;
- Exploring load management technologies and strategies, such as Smart Grid and demand-side management techniques;
- Identifying how communities can become more involved in energy efficiency actions;
- Considering new and creative means to communicate the many benefits of energy efficiency actions to consumers;
- Developing the most efficient means to deliver energy efficiency to consumers.

INTERNAL OPERATIONS DECISIONS WILL REDUCE RISKS

BPA has revised its Agency Decision Framework to improve the way managers and employees make decisions. This improved framework is a standardized, repeatable, risk-informed approach to making key business and policy decisions across a broad range of decision factors. The process provides guidelines for defined objectives, risk analysis, evaluation of alternatives, recommendations and documentation. Using the revised process, employees will be able to inform decision makers through recommendations before

the agency's resources are committed. More than 400 employees have participated in the initial phase of ADF training.

PROCESS EFFICIENCY PROGRAM SEES PAYBACK

BPA's Enterprise Process Improvement Program, begun in 2004, is a multi-year, cross-agency effort to improve efficiency and increase value through such tools as standardized processes, greater automation and consolidation.

This year, EPIP reduced the agency's costs by \$67.9 million and is on track to reduce another \$55 million to \$65 million a year in 2009–2010. EPIP saved BPA \$112.4 million in program costs in 2006 and 2007. Further savings will accrue as remaining process improvements are implemented.

Without EPIP, our budgets would be an average \$62 million a year higher over the next three years. That doesn't mean our net program costs are declining by those amounts; in some areas, new program demands and increasing external costs are raising the bottom line. But the continuing EPIP savings are keeping our net costs significantly lower than they would have been.

All EPIP analysis is now complete. Major implementation of EPIP process improvements is under way this year and next, with significant related Information Technology development remaining in 2011. At that point, EPIP as a program will conclude; however, we will seek to continuously improve our systems and processes.

FOOTNOTES

- 1 Unless otherwise noted, all figures in this report refer to the fiscal year which begins Oct. 1 and runs through Sept. 30.
- 2 Energy Northwest is a consortium of Washington state utilities that own and operate the region's only operating nuclear plant, Columbia Generating Station. BPA-backed construction of Energy Northwest nuclear projects, pays for CGS operation and includes the output of the CGS in its resource portfolio.
- 3 NFB (an embedded acronym) stands for **N**ational Marine Fisheries Service **F**ederal Columbia River Power System **B**iological Opinion. The NFB adjustment allows BPA to increase its cost recovery adjustment cap under certain conditions related to fish operations.
- 4 Preference customers are public utilities, cooperatives or public bodies (such as municipalities and public utility districts) that, by law, have priority access to federally generated power. They are also referred to as "consumer-owned utilities."
- 5 BPA has established "High Water Marks" that define how much power a preference utility may buy at Tier 1 prices. The HWM is based on a utility's net requirement load (the utility's load minus its own resources) as of 2010.
- 6 Environmentally Preferred Power is a BPA green power product sold to preference customers in the Pacific Northwest. EPP is a blend of new and existing wind and low-impact hydro.
- 7 The Northwest Power and Conservation Council is an interstate compact authorized by the Northwest Power Act. Its members are appointed by the governors of Washington, Oregon, Idaho and Montana. The Council develops and updates regional power plans and fish and wildlife programs which guide BPA and others' actions.
- 8 A flowgate is a collection of geographically close transmission lines through which electricity must flow to reach its intended destination. The total capacity limit for the flowgate is often less than the sum of capacity limits of the individual lines because of interactions between systems.
- 9 A balancing authority area is a specific geographic area in which a responsible entity maintains transmission system frequency. Balancing authorities usually rely on power plants within their balancing authority area to keep loads and generation in balance.
- 10 OASIS stands for Open Access Same-time Information System, a common transmission reservation site.
- 11 In November 2008, the Shoshone-Bannock Tribes signed the Accords for an additional investment of approximately \$61 million.
- 12 NOAA Fisheries Service is the Northwest regional office's preferred name for the National Marine Fisheries Service. NOAA stands for National Oceanic and Atmospheric Administration, which is part of the U.S. Department of Commerce.
- 13 Leadership in Energy and Environmental Design.



WORKING WITH TRIBES

The Columbia Basin Fish Accords reflect a new spirit of collaboration among Northwest federal agencies, tribes and state governments. To celebrate, on May 2, 2008, representatives of four Indian tribes and three federal agencies signed a ceremonial deerskin at Horsethief Lake State Park in Washington on the shore of the Columbia River.

Pictured left to right: COLONEL STEVEN MILES, Northwest division commander, U.S. Army Corps of Engineers; ANTONE MINTHORN, chairman, Confederated Tribes of the Umatilla Indian Reservation; MIKE MARCHAND, chairman, Confederated Tribes of the Colville Indian Reservation; RALPH SAMPSON, chairman, Confederated Tribes and Bands of the Yakama Nation; TIM PERSONIUS, deputy regional director, Bureau of Reclamation; STEVE WRIGHT, administrator, Bonneville Power Administration; RON SUPPAH, chairman, Confederated Tribes of the Warm Springs Reservation of Oregon; and FIDELIA ANDY, chairwoman, Columbia River Inter-Tribal Fish Commission.

PERFORMANCE TARGET RESULTS

For the last dozen years, BPA has set key agency targets that the organization as a whole is responsible for achieving in the specified year. These targets serve as indicators of the agency's annual performance.

STAKEHOLDER PERSPECTIVE

TRANSMISSION SYSTEM INFRASTRUCTURE

TARGET MET. BPA met its transmission capital work plan management target on time and within budget by completing 22 of 24 specified capital sub-portfolios. The two sub-portfolios to be completed include the Wood Pole Replacement and Big Eddy Transformer Replacement.

COMMERCIAL INFRASTRUCTURE

TARGET MET. BPA successfully dealt with growing long-term network transmission service requests by developing and implementing a strategy to manage its transmission queue and finalizing a financial/risk model to be used in the formal commercial infrastructure evaluation. BPA conducted a Network Open Season that secured 6,410 MW of long-term customer commitments and removed transmission service requests from the request queue where customers did not sign long-term contracts.

HYDRO GENERATION SYSTEM

TARGET MET. Generation was increased by 4.5 average megawatts through two runner replacements at Grand Coulee Dam, and work was completed on budget for \$9.7 million, well within the \$7 million to \$12 million target range.

ENERGY EFFICIENCY/DEMAND MANAGEMENT

TARGET MET. BPA achieved 76.2 average megawatts of new conservation savings based on a target of 47 to 57 average megawatts, and did so based on an average cost of under \$1 million per average megawatt against a target of between \$1.4 million to \$1.5 million.

TRANSMISSION RELIABILITY

TARGET NOT MET. BPA had two high-risk factor, high-violation severity level compliance events related to vegetation-caused outages. In August, BPA completed a Remedial Action Directive issued by the Western Electricity Coordinating Council and subsequently reached a settlement addressing both events. BPA met the target compliance requirements for WECC's Reliability Management System, and there were no involuntary curtailments of firm load due to a reliability violation, transmission system security breach or cascading outages originating on the BPA system.

TRANSMISSION AVAILABILITY

TARGET MET. BPA's most important transmission lines were available for service 99.1 percent of the time, exceeding the target of at least 98.0 percent.

GENERATION RELIABILITY

TARGET MET. The Federal Columbia River Power System's generators experienced no violations of reliability compliance standards at any level and did not experience involuntary curtailments of firm load due to inadequate power supply or due to 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.

GENERATION AVAILABILITY

TARGET MET. BPA and its Federal Columbia River Power System partners achieved 99.6 percent heavy-load-hour availability, exceeding the target of 97.5 percent.

OUTAGE/STORM RESPONSE

TARGET MET. BPA mitigated risks related to storm and outage response by developing, testing and implementing the Storm Response Incident Action Plan.

REGIONAL DIALOGUE IMPLEMENTATION

TARGET MET. BPA implemented the following Regional Dialogue tasks: (1) developed Regional Dialogue contracts ready to be offered to regional customers; (2) developed a Tiered Rate Methodology Record of Decision that carries out certain aspects of the Regional Dialogue Policy; (3) filed Average System Cost Methodology with the Federal Energy Regulatory Commission in July; and (4) completed a revised filing for the 2007–2009 power rate case to enable Regional Dialogue contracts to be signed by the end of the calendar year.

REGIONAL TRANSMISSION COORDINATION

TARGET MET. BPA's successful collaboration with ColumbiaGrid resulted in (1) growth in membership with the participation of Cowlitz County PUD in the ColumbiaGrid Planning and Expansion Functional Agreement; (2) successful implementation of regional transmission planning responsibilities including a 10-year compilation transmission plan and a Final System Assessment; (3) a decision agreed to by seven ColumbiaGrid members to develop reliability functions through a joint initiative rather than developing a second reliability functional agreement; and (4) development of a Common OASIS Functional Agreement signed by eight parties including BPA.

ORDER 890 IMPLEMENTATION

TARGET MET. BPA established an Order 890 Implementation Plan that addresses (1) potential conflicts between FERC's pro forma tariff and BPA's statutes; (2) potential impairment of the efficient and reliable operation of the Pacific Northwest power and transmission system; (3) specific technical issues discussed publicly with external transmission stakeholders; and (4) consistency of BPA's processes and

systems to implement the tariff. BPA also readied an updated tariff filing with FERC, submitted on Oct. 3, 2008, that considered public discussions with external transmission stakeholders.

ENDANGERED SPECIES ACT COMPLIANCE

TARGET MET. BPA engaged in a collaboration that resulted in a substantial and historic agreement with sovereign parties (state/tribal/federal) in the region on the new Biological Opinion and, successfully obtained “roll over” of the 2007 Biological Opinion for 2008 with little revision to implementation actions as a result of court action.

GREENHOUSE GAS

TARGET MET. BPA developed and began implementation of a Climate Change Action Plan including joining the Climate Registry and developing a draft Climate Change Technology Roadmap.

CUSTOMER SATISFACTION

TARGET MET. Survey results showed a customer satisfaction rating of 7.8, exceeding the target range of 7.0 to 7.5 out of 10.

CONSTITUENT SATISFACTION

TARGET MET. Survey results showed a constituent satisfaction rating of 7.8, exceeding the target range of 7.0 to 7.5 out of 10.

TRIBAL GOVERNMENT SATISFACTION

TARGET MET. Survey results showed a tribal government satisfaction rating of 7.3, exceeding the target range of 6.0 to 6.5 out of 10.

FINANCIAL PERSPECTIVE

MODIFIED NET REVENUE

TARGET MET. BPA’s modified net revenue was \$157 million against a target range of \$50 million to \$175 million.

TREASURY PAYMENT

TARGET MET. BPA’s FY 2008 payments to the U.S. Treasury of \$963 million were made on time and in full for the 25th consecutive year.

DEBT OPTIMIZATION

TARGET MET. BPA completed the \$147 million Energy Northwest/BPA bond refinancing and extension to 2013–2018. In addition, early federal debt amortization of \$211 million Treasury debt occurred on Sept. 30, 2008.

BOND RATING

TARGET MET. BPA maintained ratings of “AA-” or better from all three credit rating agencies for BPA-backed bonds as affirmed by Moody’s (Aaa), Standard and Poor’s (AA-), and Fitch (AA-) in June.

INTERNAL OPERATING COSTS

TARGET NOT MET. BPA’s overall internal operating costs were \$545 million against a target range of \$539 million to \$525 million.

INTERNAL OPERATIONS PERSPECTIVE

PROCESS IMPROVEMENT

TARGET MET. BPA achieved the FY 2008 milestones of all seven targeted efficiency implementations in the Enterprise Process Improvement Program in the following areas: Asset Management; Human Capital Management; Information Technology; Marketing and Sales; Transmission Operations and Maintenance; Transmission Plan, Design, Build; and Supply Chain.

GOVERNANCE AND INTERNAL CONTROLS

TARGET MET. BPA completed documentation for two high-risk processes, transmission billing determinants and power hydro desk operations.

PEOPLE AND CULTURE PERSPECTIVE

WORKFORCE GAP CLOSURE

TARGET MET. BPA implemented 93 percent of the agency workforce plan actions to effectively recruit, retain and develop critical skills and occupations, exceeding the target of 80 percent.

EMPLOYEE UNDERSTANDING OF BUSINESS STRATEGY

TARGET MET. Based on an annual employee survey, 82 percent of employees confirmed that they understand BPA’s business strategy and see a connection between the work they do and BPA’s business strategies, well within the target range of 70 to 80 percent.

SAFETY

TARGET MET. BPA achieved a lost-time accident frequency rate (AFR) of 1.5. This is 29 percent below the average AFR of 2.1 for the Transmission, Control, and Distribution Industry as reported by the Bureau of Labor Statistics.

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BPA PROFILE

The Bonneville Power Administration is a 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 non-federal power plants. BPA also operates and maintains about three-fourths of the region's high-voltage transmission. About one-third of the electric power used in the Northwest comes from BPA.

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

In its vision statement, BPA dedicates itself to providing high system reliability, low rates consistent with sound business principles, environmental stewardship and accountability. BPA's core values are trustworthy stewardship, collaborative relationships and operational excellence.

FORWARD-LOOKING INFORMATION

This Forward-Looking Information contains statements which, to the extent they are not recitations of historical fact, constitute "forward-looking statements." In this respect, the words "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. A number of important factors affecting Bonneville Power Administration's business and financial results could cause actual results to differ materially from those stated in the forward-looking statements. BPA does not plan to issue any updates or revisions to the forward-looking statements.

NEW LONG-TERM POWER SALES CONTRACTS

At the end of calendar year 2008, BPA expects to sign new wholesale power contracts with its public preference customers (consumer-owned utilities) to cover fiscal years 2012-2028. Preference customers are public utilities, cooperatives or public bodies, such as municipalities and public utility districts, that by law have priority access to federally generated power. The contracts are expected to provide both the agency and its customers

with greater long-term financial stability and protection from a volatile energy market through a new tiered rate structure.

Customers will have a contract-defined right to purchase an amount of power at Tier 1 rates. Power at Tier 1 rates would be limited to the output of the federal system with very limited augmentation. Because they are tied to the low-cost federal system, Tier 1 rates are expected to remain relatively low and stable.

As customers need more power to meet load growth, they will have the choice of purchasing it from BPA at Tier 2 rates or securing their own resources. Tier 2 rates would be set to cover the full cost of the additional power BPA buys to meet those additional loads.

RESOURCE PROGRAM

BPA is developing its Resource Program in coordination with the Northwest Power and Conservation Council's Sixth Power Plan. The Resource Program will examine the agency's projected load-resource balance; describe how to fill any projected deficits by analyzing the costs, risks and environmental characteristics of possible resource portfolios; and then

identify a preferred resource portfolio for future resource acquisitions. BPA plans to issue a draft Resource Program in July 2009 and a final in October 2009.

RATES

The Pacific Northwest Electric Power Planning and Conservation Act of 1980 directs the administrator to establish and periodically review and revise rates for the sale and disposition of electric energy and capacity and for the transmission of nonfederal power. Rates are to be set to recover, in accordance with sound business principles, the costs associated with the acquisition, conservation and transmission of electric power, including the amortization of the federal investment in the Federal Columbia River Power System (FCRPS) over a reasonable period of years. The revised rates based on the WP-07 Supplemental Final Proposal, as published in the 2007 Wholesale Power Rate Schedules, received interim approval from the Federal Energy Regulatory Commission on Oct. 31, 2008, for fiscal year 2009 rates.

We expect that the revised rates will be in place for the entire year unless a National Marine Fisheries Service FCRPS Biological Opinion Emergency (NFB) Surcharge is deemed necessary. As in the original rate filing, these rates for fiscal year 2009 again include a Cost Recovery Adjustment Clause that allows BPA a temporary upward adjustment to power rates of up to \$300 million (the CRAC cap). The CRAC is triggered when accumulated modified net revenues reach thresholds as established in the rate case. A Dividend Distribution Charge, which could reduce rates under certain circumstances, was also included. These adjustments were not needed in fiscal year 2008, and were also not necessary for fiscal year 2009. However, the rates also include an Emergency NFB Surcharge for a qualifying within-year adjustment triggered by certain events associated with the litigation over the 2004 Biological Opinions and an agency Treasury Payment Probability below 80 percent. Should BPA's financial conditions deteriorate significantly during fiscal year 2009 and should there also be significant fish costs associated with a qualifying trigger event, then a rate adjustment could be possible.

DIRECT-SERVICE INDUSTRIES

BPA has not yet made a decision about service to direct-service industrial customers post 2011. The agency continues to explore various means of providing service benefits, including a financial mechanism similar to the current contracts, which will provide the region with known, capped costs. BPA also is considering power deliveries, which would be priced at the Industrial Firm Power Rate, as developed in future rate cases. BPA is continuing discussions with two aluminum companies for potential contracts.

TRANSMISSION

BPA conducted a successful network open season for those customers seeking capacity on BPA's transmission system network. The bulk of the requests were associated with wind energy projects. The agency is now conducting cluster studies to determine aggregate net impacts of all service requests. It is expected that the cluster studies will show that new transmission will be needed. The studies will also help determine the costs of any investments in new infrastructure and whether there is sufficient contractual commitment from customers to cover these incremental costs in transmission service rates.

FISH AND WILDLIFE

Litigation related to biological opinions issued by National Oceanic and Atmospheric Administration Fisheries has been ongoing for several years. The biological opinions govern how the federal hydropower system should be operated to protect and recover endangered species. While BPA is not a party to the suits brought by environmental groups, the outcome of litigation would affect Northwest ratepayers since BPA incurs the bulk of costs, both direct expenditures and lost revenues, related to hydro operations on behalf of endangered fish.

While it is difficult to predict future financial impacts, there have been some positive developments. In late August 2008, U.S. District Court of Oregon signaled a non-litigative approach, encouraging the parties to continue talking through the issues rather than subjecting the current biological opinion to a

science review. Additionally, the Columbia Basin Fish Accords with three federal agencies, four Northwest tribes, Columbia River Inter-Tribal Fish Commission and two states commit BPA to funding specific fish and wildlife programs for 10 years. A fifth tribe signed the agreements in early November 2008. In return, the parties have agreed that the federal government's requirements under the Endangered Species Act, Clean Water Act and Northwest Power Act are satisfied for the next 10 years and that they will support these agreements in all appropriate venues.

After the initial ramp-in period, the new work for the biological opinion results in an estimated 3 percent increase in BPA's costs. Together, the Columbia Basin Fish Accords and the biological opinion are expected to result in about a 4 percent increase in BPA's costs since

some of the Columbia Basin Fish Accords costs overlap with the estimated biological opinion costs. BPA has included the estimated costs of implementing the Columbia River Fish Accords and biological opinion in the rates set for fiscal year 2009. These increased costs do not include potential costs from additional agreements, biological opinions or court orders.

ENVIRONMENTAL

From time to time, there are sites where BPA, the U.S. Army Corps of Engineers or the Bureau of 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.

RESIDENTIAL EXCHANGE PROGRAM

The agency's Residential Exchange Program (REP) was established by the Northwest Power Act as a mechanism to distribute financial benefits of the FCRPS to residential and small-farm customers of the region's investor-owned utilities (IOUs) and a few consumer-owned utilities that have high average system costs. In 2000, BPA reached settlement agreements with IOUs over exchange benefits. In May 2007, the United States Court of Appeals for the Ninth Circuit (Ninth Circuit Court) held that BPA's 2000 REP settlements were inconsistent with the Northwest Power Act and that BPA improperly allocated the costs of the REP settlements to its Priority Firm preference rate.

To respond to the Ninth Circuit Court, BPA initiated a 2007 Supplemental Wholesale Power Rate Case (WP-07 Supplemental Rate Case) in 2008. The proceedings concluded with a signed Final Record of Decision (Final ROD) on Sept. 22, 2008, which revised BPA's power rates for fiscal year 2009. During the proceeding, BPA determined the amount of overpayments

made to the IOUs under the Residential Exchange settlements and the amounts to be refunded to consumer-owned utilities. BPA also updated its Northwest Power Act Section 7(b)(2) Legal Interpretation and Section 7(b)(2) Implementation Methodology. These guidelines are used to implement a rate test to determine the rates to be charged to consumer-owned utilities and the rate protection afforded such utilities. Concurrent with the WP-07 Supplemental Rate Case but in a separate administrative proceeding, BPA reviewed and updated the 1984 Average System Cost (ASC) Methodology to recognize changes in energy markets and/or policy decisions over the past 20 years. In June 2008, BPA issued a Final ROD on the 2008 ASC Methodology, which was used to establish ASCs required for determining IOUs' and other utilities' exchange benefits.

With the various updates and implementation decisions surrounding the REP, there remains considerable uncertainty for the parties as to how REP issues may evolve in the future.

MANAGEMENT'S DISCUSSION & ANALYSIS

RESULTS OF OPERATIONS

OPERATING REVENUES

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

	2008	2007	2006
Gross sales:			
Power	\$ 2,323,087	\$ 2,578,749	\$ 2,986,019
Transmission	683,964	652,172	605,324
Bookouts	(109,704)	(94,705)	(220,911)
Sales	2,897,347	3,136,216	3,370,432
Derivative instruments	(30,564)	(6,519)	(100,093)
U.S. Treasury credits for fish	100,392	66,097	76,353
Miscellaneous revenues:			
Power	31,895	35,730	36,869
Transmission	37,548	37,116	35,808
Total operating revenues	\$ 3,036,618	\$ 3,268,640	\$ 3,419,369

FISCAL YEAR 2008 COMPARED TO FISCAL YEAR 2007

For the fiscal year ended Sept. 30, 2008, Power Services and Transmission Services combined gross sales decreased \$224 million, or 7 percent, from the prior year.

Power Services gross sales decreased \$256 million, or 10 percent. The change was primarily due to the following key factors:

- In fiscal year 2008 there was a downward adjustment of \$341 million due to the impacts of the WP-07 Supplemental Wholesale Power Rate Case proceeding on the Residential Exchange Program;
- There was a slight increase in long-term contractual obligations and sales under existing contracts resulting in a \$24 million increase in revenues from firm power sales;
- Due to a below-average water year and a delayed but rapid runoff, BPA purchased an additional one million megawatt-hours of power in the spring to meet projected river operation needs. Once these needs

were met, remaining power was sold at a slightly higher price, resulting in a \$61 million increase in revenues.

The WP-07 Supplemental Wholesale Power Rate Case Final ROD was issued on Sept. 22, 2008. Among other things, the Final ROD established amounts to be returned to consumer-owned utilities as computed based upon what had been charged consumer-owned utilities for IOU REP benefits in fiscal years 2007 and 2008 versus the revised IOU REP benefits for the same period. The \$341 million represents the \$257 million refund of amounts to be returned to customers over collected in fiscal years 2007 and 2008, plus the effects of the \$67 million Lookback Amount applied in fiscal year 2008, and \$17 million collected in rates in 2003 for IOU benefits deferred.

Transmission Services gross sales increased \$32 million, or 5 percent. The change was primarily due to the following key factors:

- Network and intertie transmission sales and their associated ancillary services increased. Significant reasons for the increased revenues were the result of

increased Point-to-Point and intertie long-term and Point-to-Point short-term sales. There was also a slight increase in Point-to-Point and intertie long-term rates from last fiscal year;

- The increase in revenues was offset by Ancillary Services primarily by elimination of revenues from customers using ancillary service product Reactive Supply and Voltage from Generation. This was a result of an agreement during the 2008 Rate Case Settlements that Transmission does not pay its affiliate for Reactive Power inside the band.

BPA's revenues from electricity sales and expenses associated with non-trading energy activities that are "booked out" (settled other than by the physical delivery of power) are reported on a "net" basis in both operating revenues and purchased power expense. The accounting treatment has no effect on net revenue, cash flows or margins. The increase in bookouts was due to the increase in power purchases, which more than offset the slight decline in federal generation.

The change in the unrealized fair value of BPA's derivative portfolio of \$24 million was due to fluctuations in the forward price curves, physical delivery and a change in the overall portfolio mix. The change is primarily the result of a \$17 million decrease in the value of swap agreements due to a decrease in the LIBOR index rate.

U.S. Treasury credits for fish increased \$34 million, or 52 percent, as streamflows declined and market prices for purchased power increased.

In total, operating expenses decreased \$31 million, or 1 percent from fiscal year 2007. Operations and maintenance decreased \$313 million, or 20 percent, for the fiscal year from the prior year, as reported in the Combined Statements of Revenues and Expenses. The decline was the result of a \$341 million provision for rate refunds related to the REP previously discussed. Purchased power increased \$140 million, or 45 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 \$136 million, or 40 percent,

due to increased amortization for Energy Northwest's Nuclear Project No. 1 and Project No. 3 bonds. The lower amortization for the prior year was the result of extension of nonfederal debt and early repayment of federal debt within the total FCRPS debt portfolio. 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.

Interest expense declined \$4 million, or 1 percent. The primary driver for the decreased interest expense between years was a reduction of outstanding appropriated funds owed the U.S. Treasury. This decrease was partially offset by BPA's Lease Financing Program interest expense. Interest income increased \$6 million, or 8 percent, due to earnings on higher cash balances.

FISCAL YEAR 2007 COMPARED TO FISCAL YEAR 2006

For the fiscal year ended Sept. 30, 2007, revenues from combined Power Services and Transmission Services sales decreased \$360 million, or 10 percent, from the prior year.

Power Services sales declined \$407 million, or 14 percent. The change was primarily due to the following key factors:

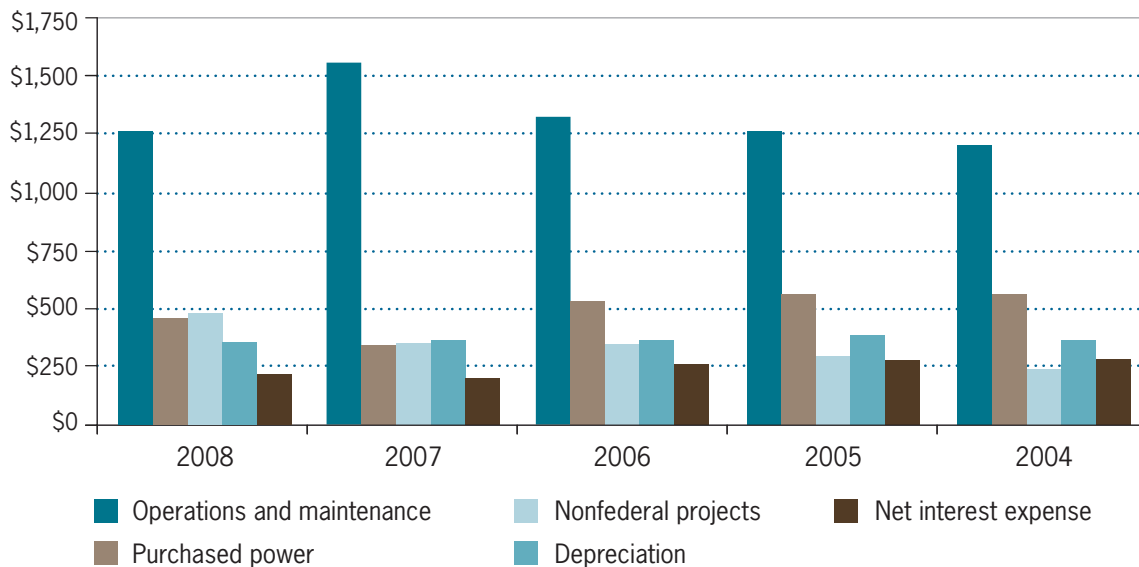
- Reduced streamflows, the biannual refueling of the Columbia Generating Station nuclear power plant and reduced power purchases drove down generation; therefore, less secondary energy was available for sale;
- Under interim rates during fiscal year 2007, BPA provided monetary benefits rather than power to the DSIs;
- Under settlement agreements, BPA provided monetary benefits rather than power for residential and small-farm customers of the IOUs.

Transmission Services sales increased \$47 million, or 8 percent, from the prior fiscal year. The change was primarily due to the following key factors:

- The increase was mainly due to increased sales under long-term Point-to-Point network and short-term intertie contracts;

EXPENSES BY CATEGORY

Millions of dollars



- Load-based sales also increased due to greater than anticipated load growth;
- Part of the increase was associated with revenues from Ancillary Services, which varied with the sale of transmission and were needed to ensure efficient and reliable service.

The increase in the unrealized fair value of BPA's derivative instruments of \$94 million, or 93 percent, was due primarily to the impact of decreasing forward price curves on BPA's sales contracts.

U.S. Treasury credits for fish decreased \$10 million, or 13 percent, because purchased power decreased.

In total, operating expense increased \$28 million, or 1 percent from fiscal year 2006. Operations and maintenance costs increased \$249 million, or 19 percent, for the fiscal year ended Sept. 30, 2007, from the prior fiscal year, as reported in the Combined Statements of Revenues and Expenses. The increase was primarily a result of IOU Residential Exchange benefits payments. Through fiscal year 2006, IOU Residential Exchange benefits were mostly made to purchase back power to meet other

firm power sales obligations and were allocated to augmentation power purchases. These augmentation power purchases were included in purchased power. In the rate period beginning on Oct. 1, 2006, the IOU Residential Exchange benefits settlements were entirely monetary payments pursuant to agreements intended to settle the REP benefits provided by the Northwest Power Act. Those payments were included in operations and maintenance expenses. Although the nature of the payments changed, the total was approximately the same.

Increased costs for operating the Columbia Generating Station nuclear power plant also increased O&M costs. The budget requirements were higher than the prior fiscal year as both a maintenance outage and nuclear refueling were scheduled. A settlement with Southern California Edison for \$13 million also contributed to higher O&M costs for fiscal year 2007. The settlement was for BPA's adjustment of the Firm Power Products and Services (FPS-96) rate schedule to establish a posted rate for a capacity product SCE could purchase as part of an option feature of a power sales agreement. Purchased power decreased \$225 million, or

42 percent, compared to the fiscal year ended Sept. 30, 2006. Purchased power decreased because most augmentation purchase contracts expired at the end of fiscal year 2006. Nonfederal projects increased \$6 million, or 2 percent, due to higher debt service expense for Energy Northwest. Depreciation and amortization decreased \$1 million from fiscal year 2006.

Net interest expense for the fiscal year ended Sept. 30, 2007, decreased \$25 million, or 9 percent, compared to fiscal year 2006. Interest expense on appropriated funds increased \$9 million. Interest on borrowings from U.S. Treasury declined \$5 million. Allowance for funds used during construction increased \$5 million as higher construction work-in-progress balances at Corps and Reclamation facilities offset a reduction at

BPA from the completion of a large BPA transmission project, the Schultz-Wautoma transmission line in 2006. Interest income increased \$24 million with higher cash balances.

SELECTED QUARTERLY INFORMATION

Due to winter heating loads for Northwest utilities, the second quarters normally have the highest revenues. However, the late snow melt in fiscal year 2008 resulted in increased secondary sales in the third quarter. Maintenance on transmission facilities occurs mainly during summer, usually resulting in higher operating expenses for the fourth quarters. The REP adjustment of \$341 million previously discussed was booked in the fourth quarter of fiscal year 2008.

SELECTED QUARTERLY INFORMATION

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

	Dec 31	Mar 31	Jun 30	Sep 30	Totals
2008					
Revenues	\$797,440	\$ 847,936	\$904,447	\$517,359	\$3,067,182
Derivative instruments	(16,120)	(48,313)	37,824	(3,955)	(30,564)
Operating revenues	781,320	799,623	942,271	513,404	3,036,618
Operating expenses	691,211	657,083	717,809	477,702	2,543,805
Net interest expenses	55,616	54,463	55,557	62,332	227,968
Net revenues (expenses)	\$34,493	\$ 88,077	\$168,905	\$(26,630)	\$264,845
2007					
Revenues	\$819,166	\$ 868,151	\$ 841,415	\$ 746,427	\$3,275,159
Derivative instruments	(238)	12,521	(10,509)	(8,293)	(6,519)
Operating revenues	818,928	880,672	830,906	738,134	3,268,640
Operating expenses	662,827	617,544	585,595	708,719	2,574,685
Net interest expenses	63,413	62,801	59,802	50,731	236,747
Net revenues (expenses)	\$ 92,688	\$200,327	\$185,509	\$(21,316)	\$ 457,208
2006					
Revenues	\$851,465	\$ 932,877	\$ 875,632	\$ 859,488	\$3,519,462
Derivative instruments	(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

LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES

As a result of the factors previously discussed, the FCRPS earned net revenues of \$265 million for the fiscal year ended Sept. 30, 2008. By comparison, net revenues were \$457 million for the fiscal year ended Sept. 30, 2007.

Cash provided by operating activities of the FCRPS increased from \$872 million for fiscal year ended Sept. 30, 2007, to \$873 million for the fiscal year ended Sept. 30, 2008, as reported 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.

Cash provided by operating activities decreased from \$1.313 billion for the fiscal year ended Sept. 30, 2006, to \$872 million for the fiscal year ended Sept. 30, 2007. The \$441 million decrease was primarily due to BPA and Energy Northwest entering into a new financial arrangement in fiscal year 2006 called direct-pay. Under direct-pay, Energy Northwest's cash flow is funded by BPA monthly as needed. This improves BPA's end of year 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. Below average water and moderate market prices as contrasted with better than average precipitation, streamflows and strong market prices in the prior fiscal year also contributed to the decrease.

INVESTMENT ACTIVITIES

Cash used for investment activities of the FCRPS decreased from \$469 million for the fiscal year ended Sept. 30, 2007, to \$455 million for the fiscal year ended Sept. 30, 2008. There

was a transfer of approximately \$49 million to BPA from the federal Spectrum Relocation Fund during fiscal year 2007. These funds are required to be used for construction and replacement of telecommunications facilities and equipment over the next several fiscal years. As such, the receipts are reflected as a source of investing cash. The Special Purpose Corporations borrowed an additional \$74 million during the fiscal year, which resulted in an increase in trust fund borrowing deposits of \$23 million over the prior fiscal year.

Cash used for investment activities of the FCRPS increased from \$448 million for the fiscal year ended Sept. 30, 2006, to \$469 million for the fiscal year ended Sept. 30, 2007. A significant change between the fiscal years was a transfer to BPA from the Spectrum Relocation Fund, as previously discussed. Another significant change between the fiscal years was the deposit to Special Purpose Corporations' trust funds of \$51 million of proceeds from the Lease Financing Program, which is discussed later, for Northwest Infrastructure Financing Corporation II.

FINANCING ACTIVITIES

Cash used for financing activities of the FCRPS increased from \$153 million for the fiscal year ended Sept. 30, 2007, to \$162 million for the fiscal year ended Sept. 30, 2008. Net decreases in federal construction appropriations and nonfederal debt of \$94 million and \$120 million, respectively, were offset by increased borrowings from U.S. Treasury and customers' advances for construction of \$187 million and \$21 million, respectively. The change in nonfederal debt was primarily due to higher Energy Northwest debt service payments.

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. Under the new arrangement for borrowing, U.S. Treasury advances funds to BPA under a series of

separate obligations with terms of up to five years. This borrowing structure does not increase BPA's borrowing authority cap, but provides access to more borrowing instruments and ranges of maturities and replaces the historical borrowing practices.

Cash used for financing activities of the FCRPS decreased from \$292 million for the fiscal year ended Sept. 30, 2006, to \$153 million for the fiscal year ended Sept. 30, 2007. The reduction was the result of a \$54 million decrease in repayment of borrowings from the U.S. Treasury, federal construction appropriations decreasing \$32 million, a \$15 million decline in nonfederal debt and an increase of \$39 million of customers' advances for construction.

Net nonfederal debt decreased for two reasons. In June 2007, BPA signed a lease financing agreement with the Northwest Infrastructure Financing Corporation II for third-party financing of transmission capital investments. Under the agreement, BPA agreed to lease yet-to-be-constructed transmission assets. Fiscal year 2007 draws were \$51 million. Energy Northwest issued \$35 million in bonds to finance certain capital improvements at Columbia Generating Station nuclear power plant.

CASH BALANCES AND BPA RESERVES

At Sept. 30, 2008, the FCRPS ending cash balance on the Combined Balance Sheet was \$1.731 billion. The Corps and Reclamation combined cash balances were \$160 million.

BPA's fiscal year-end cash excluding funds transferred from the Spectrum Relocation Fund was \$1.571 billion, while deferred borrowing authority was \$75 million, the sum of which equals BPA's reserves of \$1.646 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 2007 and 2006, BPA's fiscal year-end cash and deferred borrowing authority were \$1.328 billion and \$135 million, and \$1.105 billion and \$88 million, respectively.

BPA STATUTORY BORROWING AUTHORITY

The aggregate principal amount of U.S. Treasury debt BPA is authorized 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, \$2.186 billion was outstanding as of Sept. 30, 2008. 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 borrowings from 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, 2008, the interest rates on the outstanding U.S. Treasury borrowings ranged from 2.85 percent to 8.55 percent with a weighted average interest rate of approximately 5.2 percent. The terms of the outstanding U.S. Treasury borrowings vary from three to 34 years. The term of the U.S. Treasury borrowings 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. U.S. Treasury debt can be issued with call options. At Sept. 30, 2008, BPA had eight callable borrowings on its books totaling \$389 million.

LEASE FINANCING PROGRAM

Historically, BPA has borrowed funds from the U.S. Treasury to expand and upgrade its transmission infrastructure. However, as BPA approaches its legislatively prescribed limit of that borrowing authority, it has implemented other methods of funding projects. The Lease Financing Program is an effort to use more

third-party financing to pay for BPA projects, which will help BPA preserve the amount of money it can borrow from the U.S. Treasury for infrastructure projects and other purposes. Given the amount and scope of work needed on BPA's aging transmission system, BPA would hit its statutory U.S. Treasury borrowing limit some time between 2013 and 2015 if it were to rely solely upon U.S. Treasury borrowing for projects.

BPA has entered into separate arrangements with three special purpose corporations, Northwest Infrastructure Financing Corporation and Northwest Infrastructure Financing Corporations II and III. These arrangements constitute the framework for the Lease Financing Program. The Lease Financing Program enables BPA to continue to invest in infrastructure to support a safe and reliable system for the transmission of power with a low-cost alternative to the use of limited statutory borrowing authority with the U.S. Treasury.

Under the transaction with NIFC, BPA is leasing the Schultz-Wautoma transmission line, the construction costs of which were financed by NIFC through a taxable bond issuance totaling \$119.6 million. Payment of the debt service on the bonds is secured solely by BPA's lease payments to NIFC with respect to the project. NIFC also retained BPA as construction agent for the line. BPA commenced construction of the line in April 2003 and the line was energized in December 2005.

In June 2007, BPA entered into an umbrella lease for \$90 million with NIFC II and in March 2008 entered into a similar agreement with NIFC III for \$200 million. Subsequently BPA entered into several lease commitments with each of these entities for individual transmission assets. The construction costs of the assets are being financed through bank lines of credit between NIFC II and Citibank, and between NIFC III and JP Morgan Chase & Co. Payment of the debt service on the lines of credit is secured solely by BPA's lease payments to NIFC II and NIFC III with respect to the

related transmission assets. NIFC II and NIFC III also retained BPA as construction agent to construct and install the assets. BPA commenced construction in June 2007 and expects that construction of most of the NIFC II and NIFC III assets will be completed over the next few years. Under the agreements, NIFC II and NIFC III have leased the assets to BPA until fiscal years 2014 and 2015, at which point BPA may acquire the assets for a bargain purchase price, negotiate the extension of the lease for a longer term, or arrange for the transfer of the assets to a separate owner and lease the assets from the new owner. BPA's current expectation is that it will enter into a subsequent lease for the assets and that BPA's lease payments for such lease will secure long-term financing that will better match the assets' useful lives, the proceeds of which will be used to pay off the bank line of credit.

TREASURY PAYMENT

BPA paid the U.S. Treasury \$963 million for fiscal year 2008, making it the 25th consecutive year in which BPA has made its payments on time and in full. The fiscal year 2008 payments included \$555 million in principal and \$384 million in interest for U.S. Treasury debt and for the appropriated federal investment in the FCRPS. This fiscal year's principal payment included \$211 million to repay bonds issued to the U.S. Treasury in excess of those scheduled in Federal Energy Regulatory Commission filings. BPA paid the U.S. Treasury \$24 million in other obligations, including \$18 million of additional funding for post-retirement benefit programs provided to employees associated with the operation of the FCRPS. Payments made in fiscal years 2007 and 2006 were \$1.045 billion and \$1.113 billion, including \$289 million and \$337 million, respectively, to repay federal appropriations and bonds issued to the U.S. Treasury in excess of those scheduled in FERC filings.

CREDIT RATINGS

Credit ratings on nonfederal debt backed by BPA at Sept. 30, 2008, were as follows:

- Moody's at Aaa
- Standard & Poor's at AA-
- Fitch at AA- with a positive rating outlook

CONTRACTUAL OBLIGATIONS AND FEDERAL PAYMENTS

Amounts shown in the following table for federal appropriations, borrowings from U.S. Treasury and nonfederal debt include interest and therefore are higher than amounts reflected in the Combined Balance Sheets and described in the accompanying Notes to Financial Statements — Note 6, Federal Appropriations; Note 7, Borrowings from U.S. Treasury; and Note 8, Nonfederal Debt. Asset retirement obligations also include interest and are described in Note 2, Asset Retirement Obligations. Estimated amounts for DSI benefits after 2011 are not presently known. These are described in Note 10, Commitments and Contingencies. Purchase power commitments and additional post-retirement contributions are period expenses. Additional post-retirement contributions

beyond 2009 are not presently scheduled in rates. BPA does not have a commitment for contributions until the cost is included in rates. Refer to Note 9, Other Liabilities, and Note 10, Commitments and Contingencies. Irrigation assistance is treated as a distribution from accumulated net revenues when paid. These are described in Note 10, Commitments and Contingencies.

OFF-BALANCE SHEET ARRANGEMENTS

FCRPS is not engaged in any off-balance sheet arrangements through unconsolidated limited purpose entities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Certain accounting policies require management to make estimates and judgments concerning transactions that will be settled in the future. Amounts recognized in the Combined Financial Statements from such estimates are based upon numerous assumptions involving varying and potentially significant degrees of judgment and uncertainty. Accordingly, the amounts currently reflected in the Combined Financial Statements will likely increase or decrease in the future as additional information becomes available.

CONTRACTUAL OBLIGATIONS AND FEDERAL PAYMENTS

As of Sept. 30 — thousands of dollars

	2009	2010	2011	2012	2013	2014+	Total
Federal appropriations	\$ 263,288	\$ 256,485	\$ 273,665	\$ 275,541	\$ 267,406	\$10,441,298	\$11,777,683
Borrowings from U.S. Treasury	547,215	447,221	392,487	319,212	167,061	1,321,538	3,194,734
Nonfederal debt	648,508	626,541	599,656	744,796	817,622	5,592,181	9,029,304
Asset retirement obligations	9,352	10,195	11,147	12,253	13,491	318,573	375,011
DSI benefits	55,207	59,000	59,000	—	—	—	173,207
Purchase power commitments	41,545	26,979	24,473	56,852	56,852	—	206,701
Additional post-retirement contributions	30,554	—	—	—	—	—	30,554
Irrigation assistance	7,274	—	—	1,206	60,027	615,183	683,690
Total	\$1,602,943	\$1,426,421	\$1,360,428	\$1,409,860	\$1,382,459	\$18,288,773	\$25,470,884

REGULATORY ACCOUNTING POLICY

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 either during the periods they are scheduled in rates or as the nonfederal projects debt is repaid in accordance with Statement of Financial Accounting Standards 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. 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 Note 3, Effects of Regulation, for tables summarizing regulatory assets and liabilities as of Sept. 30, 2008, and 2007. Amortization of these assets and liabilities is reflected in the Combined Statements of Revenues and Expenses.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISK MANAGEMENT

Due to the operational risk posed by fluctuations in river flows and electric market prices, net revenues that result from underlying surplus or deficit energy positions are inherently uncertain. BPA's Transacting Risk Management Committee (TRMC) has responsibility for the oversight of the market price, inventory and credit risks that arise from transacting in power markets. The TRMC establishes risk tolerances and limits that are represented in the

transactional risk policy. This policy defines the control environment through which these risks are managed. Experienced business and risk analysts and managers conduct simulation and analysis of the hydro supply system and forward market prices to derive market price and credit risk positions. These results are measured against risk limits and reported to senior management daily.

COMMODITY PRICE RISK AND VOLUMETRIC RISK

Primarily due to the variation in the available energy from its hydroelectric generation capacity, BPA enters into short- and long-term forward sales and purchase agreements in the wholesale markets to balance its energy supply and demand. Commodity price risk results from fluctuations in the electric market prices in the Pacific Northwest that affects the value of the energy inventory bought and sold as well as the value of prior purchase and sale contracts. In fiscal year 2008, there was a net surplus and sale of energy above that needed to serve the region's firm load obligations.

BPA measures the market price risk in its portfolio on a daily, weekly and monthly basis employing both parametric calculations and non-parametric Monte Carlo simulations to derive net revenues at risk, mark-to-market, value at risk, and additional risk metrics as appropriate. These methods provide 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 standard measures such as sensitivity and scenario testing to determine the impacts of a sudden change in market price, volatility, correlations or hydro inventory. These methods assume hypothetical movements in future market prices and in hydro inventory and provide an estimate of possible net revenues outcomes for BPA's portfolios. In response to market price risk, futures, forwards, swaps and option instruments may be used to mitigate BPA's exposure to price fluctuations.

BPA's principal market activity is for the sale of surplus inventory and power purchases to manage its load/resource balance rather than the purchase and sale of electricity to earn trading revenues. 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 deliver or take delivery of electricity. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. Credit risk is mitigated at BPA by reviewing counterparties for creditworthiness, establishing credit limits, and monitoring credit exposure on a daily basis. 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. 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.

During fiscal year 2008, BPA experienced no significant losses as a result of any customer defaults or bankruptcy filings. At Sept. 30, 2008, BPA had \$54 million in credit exposure to purchase and sale contracts taking into account netting rights and BPA's credit exposure, net of collateral. At Sept. 30, 2008, BPA's credit exposure to sub-investment grade counterparties was less than 1 percent of total outstanding credit exposures. The agency's top five credit exposures were \$49 million, or 91 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 has no outstanding variable rate debt with 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 \$509 million of Energy Northwest variable rate debt outstanding at Sept. 30, 2008, \$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 that is 68 percent of the LIBOR index rate. Although not a perfect match, on average over time, the amount BPA receives is intended to offset the variable rate paid on the \$500 million in bonds issued by Energy Northwest. In September and October unusual market conditions have caused some volatility in the LIBOR rate and Energy Northwest variable rate resulting in slightly higher overall net interest expense. However, this has not been material to the financial statements.

NON-GAAP FINANCIAL INFORMATION

FISH AND WILDLIFE

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 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 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 Fisheries Service and the U.S. Fish and Wildlife Service in furtherance of the ESA.

FISH AND WILDLIFE

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

	2008	2007	2006
Direct costs	\$ 327	\$ 313	\$ 286
Operational impacts:			
Replacement power purchases	275	121	168
Estimated foregone power revenues	274	282	398
Total fish and wildlife	\$876	\$716	\$852

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 Federal Energy Regulatory Commission's predecessor to the federal projects' power purpose. These measures mitigate for the impact upon fish and wildlife from constructing and operating federal hydroelectric dams.

BPA also implements and funds measures proposed in the Council's program and the biological opinions. They call for a variety of mitigation measures from habitat protection to mainstem Columbia River and Snake River flow targets and mandatory spill for passing juvenile fish over dams. Such measures affect the operation of the FCRPS, reducing power generation, and either requiring BPA to purchase power to fulfill contractual demands or to forego revenue from sales of power. The financial impacts of these investments in fish and wildlife are counted as measures funded by BPA. Some of the Council's program 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's 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's 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's 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 are the second main category of fish and wildlife costs, which include replacement power purchase costs and estimated foregone power revenues. 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. BPA accounts for such value as a fish and wildlife cost 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, or BPA power revenues are less than would have been earned absent changes in hydroelectric system operations attributable to fish and wildlife.

MODIFIED NET REVENUES

Modified net revenues are net revenues after removing the effects of the unrealized fair value of derivative instruments 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.

BPA manages the FCRPS debt portfolio to meet the objectives of maintaining sufficient financial flexibility to support operations while maximizing BPA's access to its lowest cost capital sources to meet future capital needs at the lowest cost to ratepayers. BPA's Debt Optimization Program is intended to provide BPA with cash flow flexibility to allow BPA to

advance the repayment of BPA's federal debt and thereby restore BPA's limited borrowing authority.

Under the Debt Optimization Program through Sept. 30, 2008, approximately \$2.4 billion in bonds issued by Energy Northwest have been refinanced with new bonds having final maturities mainly in calendar years 2013-2018, with some extended to 2024. These actions reduced the expense for nonfederal projects included in operating expenses and increased net revenues reported in the Combined Statements of Revenues and Expenses. This is because the related regulatory assets are not amortized until the principal on the outstanding nonfederal bonds is repaid. As a result of the actions taken under the Debt Optimization Program, BPA prepaid federal appropriations and borrowings from U.S. Treasury of \$210 million, \$289 million and \$342 million in fiscal years 2008, 2007 and 2006, respectively. Since inception of the Debt Optimization Program, prepayments to the U.S. Treasury have increased accumulated net revenues by \$2.175 billion, \$1.964 billion and \$1.675 billion at Sept. 30, 2008, 2007 and 2006, respectively.

MODIFIED NET REVENUES

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

	2008	2007	2006
Net revenues	\$ 264,845	\$ 457,208	\$ 611,063
Derivative instruments	30,564	6,519	100,093
Nonfederal debt management actions	(137,963)	(246,421)	(266,249)
Modified net revenues	\$157,446	\$217,306	\$ 444,907

The primary change in modified net revenues from fiscal year 2006 through fiscal years 2007 and 2008 is due to streamflows and market prices as previously discussed.

FINANCIAL STATEMENTS

COMBINED BALANCE SHEETS

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

ASSETS

	2008	2007
Federal utility plant		
Completed plant	\$ 13,480,633	\$ 13,278,856
Accumulated depreciation	(4,933,348)	(4,825,295)
	8,547,285	8,453,561
Construction work in progress	890,883	851,620
Net federal utility plant	9,438,168	9,305,181
Nonfederal generation		
	2,492,645	2,465,230
Current assets		
Cash	1,731,238	1,475,544
Accounts receivable, net of allowance	112,129	140,335
Accrued unbilled revenues	203,011	181,526
Materials and supplies, at average cost	75,719	68,334
Prepaid expenses	21,682	19,938
Total current assets	2,143,779	1,885,677
Other assets		
Regulatory assets	5,447,404	5,938,724
Nonfederal nuclear decommissioning trusts	157,743	162,438
Deferred charges and other	176,045	206,398
Total other assets	5,781,192	6,307,560
Total assets	\$ 19,855,784	\$ 19,963,648

The accompanying notes are an integral part of these statements.

CAPITALIZATION AND LIABILITIES

	2008	2007
Capitalization and long-term liabilities		
Accumulated net revenues	\$ 2,664,460	\$ 2,402,565
Federal appropriations	4,247,972	4,326,688
Borrowings from U.S. Treasury	1,745,500	1,760,900
Nonfederal debt	6,182,403	6,262,295
Total capitalization and long-term liabilities	14,840,335	14,752,448
Commitments and contingencies (Note 10)		
Current liabilities		
Federal appropriations	9,889	10,913
Borrowings from U.S. Treasury	440,400	479,600
Nonfederal debt	284,469	288,758
Accounts payable and other	588,275	346,352
Total current liabilities	1,323,033	1,125,623
Other liabilities		
Regulatory liabilities	2,665,517	2,050,228
IOU exchange benefits	69,600	1,068,217
Asset retirement obligations	159,800	175,500
Deferred credits	797,499	791,632
Total other liabilities	3,692,416	4,085,577
Total capitalization and liabilities	\$ 19,855,784	\$ 19,963,648

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

	2008	2007	2006
Operating revenues			
Sales	\$2,897,347	\$ 3,136,216	\$ 3,370,432
Derivative instruments	(30,564)	(6,519)	(100,093)
U.S. Treasury credits for fish	100,392	66,097	76,353
Miscellaneous revenues	69,443	72,846	72,677
Total operating revenues	3,036,618	3,268,640	3,419,369
Operating expenses			
Operations and maintenance	1,256,213	1,569,504	1,320,880
Purchased power	450,035	310,073	535,020
Nonfederal projects	479,493	343,321	337,627
Depreciation and amortization	358,064	351,787	353,236
Total operating expenses	2,543,805	2,574,685	2,546,763
Net operating revenues	492,813	693,955	872,606
Interest expense and (income)			
Interest expense	340,658	344,379	340,586
Allowance for funds used during construction	(32,057)	(33,172)	(28,514)
Interest income	(80,633)	(74,460)	(50,529)
Net interest expense	227,968	236,747	261,543
Net revenues	264,845	457,208	611,063
Accumulated net revenues at Oct. 1	2,402,565	1,945,357	1,334,294
Irrigation assistance	(2,950)	—	—
Accumulated net revenues at Sept. 30	\$2,664,460	\$2,402,565	\$1,945,357

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	Borrowings from U.S. Treasury	Nonfederal Debt	Total
Balance at Sept. 30, 2006	\$1,945,357	\$4,323,729	\$2,481,800	\$6,515,258	\$15,266,144
Federal construction appropriations:					
Increase	—	125,972	—	—	125,972
Repayment	—	(112,100)	—	—	(112,100)
Borrowings from U.S. Treasury:					
Increase	—	—	315,000	—	315,000
Repayment	—	—	(506,300)	—	(506,300)
Refinanced	—	—	(50,000)	—	(50,000)
Nonfederal debt:					
Increase	—	—	—	66,148	66,148
Repayment	—	—	—	(30,353)	(30,353)
Net revenues	457,208	—	—	—	457,208
Balance at Sept. 30, 2007	\$ 2,402,565	\$ 4,337,601	\$2,240,500	\$ 6,551,053	\$ 15,531,719
Federal construction appropriations:					
Increase	—	70,929	—	—	70,929
Repayment	—	(150,669)	—	—	(150,669)
Borrowings from U.S. Treasury:					
Increase	—	—	425,000	—	425,000
Repayment	—	—	(404,600)	—	(404,600)
Refinanced	—	—	(75,000)	—	(75,000)
Nonfederal debt:					
Increase	—	—	—	58,242	58,242
Repayment	—	—	—	(142,423)	(142,423)
Net revenues	264,845	—	—	—	264,845
Irrigation assistance	(2,950)	—	—	—	(2,950)
Balance at Sept. 30, 2008	\$ 2,664,460	\$ 4,257,861	\$2,185,900	\$ 6,466,872	\$ 15,575,093

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

	2008	2007	2006
Cash provided by operating activities			
Net revenues	\$ 264,845	\$ 457,208	\$ 611,063
Non-cash items:			
Depreciation and amortization	358,064	351,787	353,236
Amortization:			
Terminated facilities and sponsored conservation	131,393	21,373	11,672
Capitalization adjustment	(64,905)	(64,905)	(64,905)
Changes in:			
Receivables and unbilled revenues	6,721	62,736	(87,612)
Materials and supplies	(7,385)	3,431	3,308
Prepaid expenses	(1,744)	1,515	299,579
Accounts payable and other	185,839	39,140	186,751
Cash provided by operating activities	872,828	872,285	1,313,092
Cash provided by and (used) for investment activities			
Investment in:			
Federal utility plant (including AFUDC)	(412,055)	(435,758)	(402,474)
Nonfederal projects	(27,415)	(30,165)	(45,620)
Transfer from Spectrum Relocation Fund	—	48,627	—
Nonfederal nuclear decommissioning trusts	(7,300)	(6,691)	—
Special purpose corporation's trust funds:			
Deposits to	(74,474)	(51,070)	—
Receipts from	65,779	5,955	—
Cash used for investment activities	(455,465)	(469,102)	(448,094)
Cash provided by and (used for) financing activities			
Federal construction appropriations:			
Increase	70,929	125,972	83,351
Repayment	(150,669)	(112,100)	(101,223)
Borrowings from U.S. Treasury:			
Increase	425,000	315,000	270,000
Repayment	(404,600)	(506,300)	(545,000)
Refinanced	(75,000)	(50,000)	(20,000)
Nonfederal debt:			
Increase	58,242	66,148	36,581
Repayment	(142,423)	(30,353)	(15,372)
Customers:			
Advances for construction	70,356	44,434	—
Billing credits	(10,554)	(5,515)	—
Irrigation assistance	(2,950)	—	—
Cash used for financing activities	(161,669)	(152,714)	(291,663)
Increase in cash	255,694	250,469	573,335
Beginning cash balance	1,475,544	1,225,075	651,740
Ending cash balance	\$ 1,731,238	\$ 1,475,544	\$ 1,225,075
Cash paid for interest, net of U.S. Treasury credits	\$ 160,586	\$ 243,010	\$ 256,787

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ACCOUNTING PRINCIPLES

Combination and Consolidation of Entities

The Federal Columbia River Power System (FCRPS) financial statements combine 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) 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 (NIFCs), from which BPA leases certain transmission facilities (See Note 8, Nonfederal Debt).

BPA is the power marketing administration that purchases, transmits and markets power for the FCRPS. Each of the combined entities is separately managed and financed, but the facilities are operated as an integrated power system with the financial results combined as the FCRPS. While the costs of Corps and Reclamation projects serve multiple purposes, only the power portion of total project costs are assigned to the FCRPS through a cost-allocation process. All inter-company accounts and transactions have been eliminated from the combined financial statements.

FCRPS accounts are maintained in accordance with generally accepted accounting principles of the United States of America 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 component 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.

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.

Rates and Regulatory Authority

BPA establishes separate power and transmission rates 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 out by the Energy Policy Act of 1992, 16 U.S.C. 824. 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 United States 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.

In connection with the rate setting process, certain costs or credits may be included in rates for recovery over a future period and are recorded as regulatory assets or liabilities in accordance with generally accepted accounting principles, specifically Statement of Financial

Accounting Standards 71, "Accounting for the Effects of Certain Types of Regulation" (See Note 3, Effects of Regulation). Regulatory assets or liabilities are amortized over the periods they are included in rates. Costs are recovered through rates during the periods when the costs are scheduled to be repaid. Amortization is computed using either the straight-line method or is based upon specific amounts included in rates each year. When the straight-line method is used, it is based upon either the estimated service lives or the periods the costs are included in rates. BPA does not earn a rate of return on its regulatory assets.

Federal Utility Plant

Federal utility plant is stated at original cost and primarily includes both transmission and generation assets. Transmission assets were \$6.2 billion and \$6.1 billion, and generation assets were \$7.3 billion and \$7.2 billion at Sept. 30, 2008, and 2007, respectively. The costs of additions, major replacements and substantial betterments are capitalized. 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. Maintenance, repairs and replacements of items determined to be less than major units of property are charged to maintenance and operating expense as incurred. The cost of retiring federal utility plant units less any salvage proceeds is charged to accumulated depreciation when it is removed from service.

Depreciation

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. The net cost of removal (the difference between cost of removal and salvage) is included in depreciation rates; however, in the event there is negative salvage (the cost of removal exceeds salvage), a reclassification of non-asset retirement obligations' negative salvage reserves is

made from accumulated depreciation to a regulatory liability.

Allowance for Funds Used During Construction

Allowance for funds used during construction (AFUDC) represents the estimated cost of interest on financing the construction of new assets. AFUDC is based on the construction work in progress balance and is charged to the capitalized cost of the utility plant asset. AFUDC is a noncash reduction of interest expense.

FCRPS capitalizes AFUDC at one rate for Corps and Reclamation construction funded by congressional appropriations and at another rate for construction funded substantially by BPA. AFUDC rates for appropriated funds are stipulated in the congressional acts authorizing the construction, whereas the BPA rate approximates the cost of borrowing from the U. S. Treasury. The respective rates were approximately 4.3 percent and 5.4 percent in fiscal year 2008, 5.1 percent and 5.1 percent in fiscal year 2007, and 3.9 percent and 4.8 percent in fiscal year 2006.

Nonfederal Generation

BPA has acquired all of the generating capability of Energy Northwest's Columbia Generating Station 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 by the nonfederal entities (See Note 8, Nonfederal Debt).

Cash

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

Financial Instruments

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 in order to finance its capital programs, which include Corps and Reclamation direct-funded capital investments. Of the \$4.45 billion, \$1.25 billion is reserved for conservation and renewable resource loans and grants.

The carrying value reflected in the Combined Balance Sheets approximates fair value for the FCRPS' financial assets and current liabilities. The fair value of borrowings from the U.S. Treasury as well as bonds issued for nonfederal debt are described in Notes 7 and 8 for Borrowings from U.S. Treasury and Nonfederal Debt, respectively.

Concentrations of Credit Risks

General Credit Risk

Financial instruments that 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 receivable are spread across a diverse group of public utilities, investor-owned utilities, power marketers and others that are located throughout the Western United States and Canada. The accounts receivable exposure results 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 2008, 2007 and 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. 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 that were in turmoil during 2000 to 2001 when they experienced historically high power prices and volatility, along with continued uncertainty related to deregulation. The California Independent System Operator and California Power Exchange were customers with whom BPA had contracts for power and transmission delivery during that period and they have been unable to fully pay BPA for their purchases. BPA has recorded an allowance for doubtful accounts, which in management's best estimate is 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 agency 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. For fiscal year 2008, the FERS plan is considered fully funded because the combined contributions are equal to the cost to the federal government to provide the benefits. However, for CSRS the legislatively mandated

contribution levels do not fully cover the cost to the federal government to provide the plan benefits. Therefore, the program is considered underfunded (See Note 10, Commitments and Contingencies). Employees also may participate in the Federal Employees Health Benefits Program and/or the Federal Employees' Group Life Insurance Program, which are similarly underfunded. Retirement benefits under the federal retirement systems are payable by the U.S. Treasury.

Derivative Instruments

BPA follows the provisions of Statement of Financial Accounting Standards (SFAS) 133, "Accounting for Derivative Instruments 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 also requires that a 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 contracts that require physical delivery, are expected to be used or sold by BPA in the normal course of business, and meet the definition of capacity described in SFAS 149, 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. Recognition of these contracts in Sales or Purchased power costs in the Combined Statements of Revenues and Expenses occurs when the contracts settle.

For all other derivative transactions, BPA applies fair value accounting and records the changes in fair value in the current period in the Combined Statements of Revenues and Expenses. When available, quoted market prices or prices obtained through external sources are used to measure a contract's fair

value. For contracts without available quoted market prices, fair value is determined based on internally developed modeled prices. BPA does not apply hedge accounting.

BPA recorded a fair value unrealized loss 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 \$(30.6) million, \$(6.5) million and \$(100.1) million for fiscal years 2008, 2007 and 2006, 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 essentially replaces 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 \$(17.2) million unrealized fair value loss, a \$(2.2) million unrealized fair value loss, and an \$8.4 million unrealized fair value gain in the Combined Statements of Revenues and Expenses for fiscal years 2008, 2007 and 2006, 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 \$203 million, \$182 million and \$247 million at Sept. 30, 2008, 2007 and 2006, respectively.

Because BPA is a federal government power marketing administration, net revenues over time are committed to repayment of the U.S. government investment in the FCRPS, the

payment of certain irrigation costs (See Note 10, Commitments and Contingencies) and the payment of operational obligations, including debt for both operating and nonoperating nonfederal projects.

Interest Income

Interest income on the Bonneville Fund balances can be applied only as offset interest credits on payments to the U.S. Treasury. Offset interest credits are a noncash reduction of interest expense. Therefore, interest income is not included in the cash paid for interest reported in the Combined Statements of Cash Flows.

U.S. Treasury Credits for Fish

The Pacific Northwest Electric Power Planning and Conservation Act of 1980 obligates the BPA administrator to make expenditures for fish and wildlife protection, mitigation and enhancement for both power and nonpower 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. As such, BPA reduces its cash payments to the U. S. Treasury by an amount equal to the mitigation measures funded on behalf of the nonpower purposes.

Residential Exchange Program

In order to provide regional utilities, primarily investor-owned utilities, access to benefits from the FCRPS, Congress established the Residential Exchange Program (REP) in Section 5(c) of the Northwest Power Act. Whenever a Pacific Northwest electric utility offers to sell power to BPA at the utility's average system cost of resources (ASC), BPA purchases such power and offers, in exchange, to sell an equivalent amount of power at BPA's PF Exchange rate to the utility for resale to that utility's residential and small farm consumers.

In May 2007, the Ninth Circuit Court rulings found the 2000 Residential Exchange Settlement Agreements with investor-owned utilities inconsistent with the Northwest Power Act. In response to the Ninth Circuit Court's rulings, BPA conducted a new wholesale power rate case that supplemented the initial fiscal year 2007 rate case. The 2007 Supplemental Wholesale Power Rate Case (WP-07 Supplemental Rate Case) Final Record of Decision (Final ROD) was issued on Sept. 22, 2008. The Final ROD established a "Lookback Amount" representing BPA's overpayments to investor-owned utilities from prior years, which was also the amount over-collected from preference customers (consumer-owned utilities). Preference customers are public utilities, cooperatives or public bodies, such as municipalities and public utility districts, that by law have priority access to federally generated power.

REP costs are forecast for each year of the rate period and included in the revenue requirement for establishing rates and are collected in rates with program costs recognized when incurred net of the purchase and sale of power under the REP. Based upon the WP-07 Supplemental Rate Case, a regulatory asset and liability were recorded representing the Lookback Amount that will be collected from IOUs and returned to the consumer-owned utilities over time. In each succeeding rate case, the BPA administrator will designate the amount to be recovered from the IOUs and returned to each qualifying consumer-owned utility. These amounts will not reduce rates, but will be credits to qualifying consumer-owned utilities' bills as designated in the corresponding Final RODs. BPA recognizes a refund and reduces expense in the year it is applied, until the Lookback Amount is eliminated. These transactions are net operating revenue neutral as the same amount reduces both revenue and expense (See Note 4, Residential Exchange Program).

RECENT ACCOUNTING PRONOUNCEMENTS

BPA recognizes accounting pronouncements that may impact the financial statements and accompanying Notes. In September 2006, the

Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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. In addition, SFAS 157 establishes a hierarchy of fair value assumptions that distinguishes between independent market participant assumptions and the reporting entity's own assumptions about market participant assumptions.

BPA will adopt SFAS 157 for its financial assets and liabilities that are measured and either recorded or disclosed under fair value in fiscal year 2009. In February 2008, the FASB issued FASB Staff Position FAS 157-2, "Effective Dates of FASB Statement No. 157," (FSP FAS 157-2), which defers the effective date of SFAS 157 for all nonrecurring fair value measurements of non-financial assets and liabilities for one year. BPA is evaluating the effect of adoption and implementation of SFAS 157, which is not expected to have a material impact on BPA's financial condition, results of operations or cash flows.

In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected would be reported in net income. The provisions of SFAS 159, if elected, are effective for BPA in fiscal year 2009. BPA is evaluating the effect of the adoption and implementation of SFAS 159, which is not expected to have a material impact on its financial condition, results of operations or cash flows.

In March 2008, the FASB issued SFAS 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of SFAS 133." SFAS 161 is intended to improve financial

reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable financial statement readers to better understand how and why an entity uses derivative instruments and their effects on an entity's financial position, financial condition and cash flows. The provisions of SFAS 161 are effective for BPA in fiscal year 2009. BPA is evaluating the impact of adopting SFAS 161.

2. ASSET RETIREMENT OBLIGATIONS

As of Sept. 30 — thousands of dollars

	2008	2007
Beginning Balance	\$ 175,500	\$ 169,300
Activities:		
Accretion	7,200	7,900
Expenditures	(2,600)	(1,800)
Revisions	(20,300)	100
Ending Balance	\$ 159,800	\$175,500

FCRPS recognizes asset retirement obligations (ARO) according to the estimated fair value of the dismantlement and restoration costs associated with the retirement of tangible long-lived assets. The liability is adjusted for any revisions, expenditures and the passage of time. FCRPS also has certain tangible long-lived assets such as federal hydro projects without an associated ARO.

AROs include the following items as of Sept. 30, 2008:

- CGS decommissioning and site restoration of \$114.4 million;
- Trojan decommissioning of \$27.5 million;
- Project Nos. 1 and 4 site restoration of \$14.5 million;
- BPA PCBs, asbestos and wood poles of \$3.4 million.

In fiscal year 2008, BPA reduced the Trojan decommissioning ARO liability by \$19.9 million to reflect changes in the

settlement of demolition activities, reduction in the estimated annual cash flows related to spent fuel operations and adjustments for other decommissioning activities.

NONFEDERAL NUCLEAR DECOMMISSIONING TRUSTS

BPA also recognizes an asset that represents trust fund balances for decommissioning and site restoration costs. Decommissioning costs for CGS are charged to operations over the operating life of the project. An external trust fund for decommissioning costs is 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 from the time the plant stops operating. The plant is licensed to operate until the current operating license termination year of 2024. Trust fund requirements for CGS are

based on an NRC decommissioning cost estimate and the license termination date.

BPA has funded \$157.7 million and \$162.4 million for the Energy Northwest AROs, which is held in trusts and recorded in other assets on the Combined Balance Sheets at Sept. 30, 2008, and 2007, respectively. The trust fund balances are \$120.0 million and \$37.7 million for decommissioning and site restoration, respectively at Sept. 30, 2008. Payments to the trusts for fiscal years 2008, 2007 and 2006 were approximately \$7.3 million, \$6.7 million and \$6.2 million, respectively. The funds are invested in cash equivalents, equity and fixed income funds. The cash equivalents are valued at cost and fixed income funds and the equity funds are valued at market.

BPA directly funds Eugene Water and Electric Board'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.

3. EFFECTS OF REGULATION

As of Sept. 30 — thousands of dollars

	2008	2007
Regulatory Assets:		
Terminated nuclear facilities	\$3,674,815	\$3,856,265
REP Lookback Amount from IOUs	679,012	—
Columbia River Fish Mitigation	370,332	366,969
Conservation measures	191,300	228,213
Direct-service industries' benefits	173,207	226,464
Fish and wildlife measures	153,618	148,514
Settlements	46,533	47,032
Federal Employees' Compensation Act	34,478	37,241
Sponsored conservation	29,555	33,276
Spacer damper replacement program	28,677	19,200
Trojan decommissioning and site restoration	27,544	49,196
Terminated hydro facilities	24,725	25,625
Capital bond premiums	13,608	15,498
IOU REP benefits	—	885,231
Total Regulatory Assets	\$5,447,404	\$5,938,724

Regulatory assets include the following items:

- “Terminated nuclear facilities” include the nonfederal debt for Energy Northwest Nuclear Project Nos. 1 and 3 and 30 percent of the Trojan project. These assets are amortized as the principal on the outstanding bonds is repaid (See Note 8, Nonfederal Debt).
- “REP Lookback Amount from IOUs” is the amount recoverable from IOUs in future rate cases that reduces their benefit payments (See Note 4, Residential Exchange Program).
- “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 of 1989, Public Law 100-371. These costs will be recovered through future rates and amortized as scheduled over 75 years.
- “Conservation measures” consist of the costs of capitalized conservation measures and are amortized over periods from five to 20 years.
- “Direct-service industries’ benefits” will be recovered in rates during the periods in which the costs will be paid in fiscal years 2009 through 2011.
- “Fish and wildlife measures” consist of the 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” reflects the actuarial estimated amount of future payments for current recipients of BPA’s worker compensation benefits.
- “Sponsored conservation” relates to the nonfederal debt for Emerald People’s Utility District loans, Conservation and Renewable Energy System and City of Tacoma Conservation bonds. These were issued to finance conservation programs sponsored by BPA. The assets are amortized as the principal on the outstanding bonds is repaid.
- “Spacer damper replacement program” consists of costs to replace deteriorated spacer dampers that have been deferred and are being recovered in rates under the Spacer Replacement Program. These costs are being amortized over a period of 30 years.
- “Trojan decommissioning and site restoration” costs reflect the amount to be recovered in future rates for funding the Trojan ARO liability (See Note 2, Asset Retirement Obligations).
- “Terminated hydro facilities” include the nonfederal debt for the terminated Northern Wasco hydro project. These assets are amortized as the principal on the outstanding bonds is repaid.
- “Capital bond premiums” are the deferred losses related to refinanced debt and are amortized over the life of the new debt instruments.
- “IOU REP benefits” is the cost of the Residential Exchange Program Settlement Agreements that in fiscal year 2007 the Ninth Circuit Court found inconsistent with the Northwest Power Act (See Note 9, Other Liabilities).

As of Sept. 30 — thousands of dollars

	2008	2007
Regulatory Liabilities:		
Capitalization adjustment	\$ 1,796,511	\$ 1,861,416
REP Lookback Amount to COUs	679,012	—
Accumulated plant removal costs	157,492	140,248
CGS decommissioning and sites restoration	28,877	39,821
Other	3,625	8,743
Total Regulatory Liabilities	\$ 2,665,517	\$ 2,050,228

Regulatory liabilities include the following items:

- “Capitalization adjustment” is the difference between appropriated debt before and after refinancing per the BPA Refinancing Section of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (Refinancing Act), 16 U.S.C. 838(l). The 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 for fiscal years 2008, 2007 and 2006, respectively.
- “REP Lookback Amount to COUs” is the amount previously collected through rates that is owed qualifying consumer-owned utilities and will be credits on their future bills (See Note 4, Residential Exchange Program).
- “Accumulated plant removal costs” is the amount previously collected through rates as part of depreciation. These costs will be amortized as actual removal costs are paid.
- “CGS decommissioning and sites restoration” is the amount previously collected through rates in excess of the ARO balances for Energy Northwest Columbia Generating Station decommissioning and site restoration as well as Project Nos. 1 and 4 sites.
- “Other” is the amount collected through billing settlements, which reduces future rates.

4. RESIDENTIAL EXCHANGE PROGRAM

As provided in the Northwest Power Act, beginning in 1981 BPA entered into 20-year Residential Purchase and Sale Agreements (RPSA) with eligible regional utility customers. The RPSAs implemented the Residential Exchange Program. In 2000, BPA signed Residential Exchange Program Settlement Agreements (“REP settlements” or “settlement agreements”) with the region’s six investor-owned utilities under which BPA was to provide monetary and power benefits as a settlement of residential exchange disputes for the period July 1, 2001, through Sept. 30, 2011. BPA later signed additional agreements and amendments related to the settlement agreements with IOU customers. One such agreement provided for the elimination or deferral of certain IOU benefit payments, while later agreements and amendments provided for minimum and maximum amounts for the IOUs’ monetary benefits for fiscal years 2007 through 2011, provided that BPA would have no obligation to provide power to the IOUs in this period. BPA performed an analysis of the REP settlements and potential accounting implications associated with the settlement agreements. Based on this analysis BPA recorded a REP settlement agreement liability and regulatory asset for amounts recoverable in future rates (See Note 3, Effects of Regulation).

In May 2007, the Ninth Circuit Court ruled that the REP settlement agreements were inconsistent with the Northwest Power Act and that BPA improperly allocated settlement costs

to BPA's preference rates. Upon notification of the rulings, BPA suspended settlement agreement payments to the IOUs. As of the end of fiscal year 2007, the account balances for the liability and regulatory asset were \$1.1 billion and \$885.2 million, respectively. The difference between the liability and regulatory asset was primarily attributable to the recording of the expense (asset reduction) although payments were suspended in May 2007. Rates, however, continued to be charged based on the settlement agreement amounts in the revenue requirement. As a result of the rulings, in fiscal year 2008 the associated liability and regulatory asset for the settlement agreements were reduced to zero.

In response to the Ninth Circuit Court May 2007 rulings, BPA held the WP-07 Supplemental Rate Case. On Sept. 22, 2008, the BPA administrator issued a Final ROD that revised power rates for fiscal year 2009, determined the amount the consumer-owned utilities were overcharged in prior years, determined the forecast REP benefits for the IOUs in fiscal year 2009, and determined the amount of prior overcharges that will be returned to the consumer-owned utilities in fiscal year 2009, which will be deducted from the amount of REP benefits the IOUs would otherwise receive in that year. The prior overcharges, which amount to \$746.2 million for fiscal years 2002 through 2006, are labeled the "Lookback Amount" in the Final ROD.

The Lookback Amount represents amounts over-collected from consumer-owned utilities in prior years' rates, which also represents the amounts overpaid to the IOUs under the settlement agreements in prior years. In 2008 BPA recorded \$679.0 million as both a regulatory liability and regulatory asset as of Sept. 30, 2008, which reflects this Lookback Amount less the \$67.2 million effect of the Lookback applied in 2008 as scheduled in the Final ROD. The regulatory liability represents the amounts owed to the consumer-owned utilities that will be returned to them in future years as determined through the rate setting processes. The regulatory asset represents the amounts owed by the IOUs that will be

recovered from the IOUs through future rate setting processes as reductions in REP benefits paid in future rate periods.

As described in Note 9, in 2008 BPA also adjusted liabilities related to the REP program to reflect the net obligations resulting from REP collections in rates, and REP benefits and interim payments made in fiscal years 2007 and 2008. Additionally as a result of the Ninth Circuit Court rulings and the WP-07 Supplemental Rate Case, the liability and related regulatory asset associated with the REP settlement agreement obligations that were recorded in prior years were reduced to zero in 2008.

In addition to balance sheet effects, the WP-07 Supplemental Rate Case addressed the REP settlement agreement effects for fiscal years 2007 and 2008 with regard to resolution of amounts over-collected in rates from consumer-owned utilities and paid to the IOUs. As a result, for fiscal year 2008 BPA first recognized a reduction to Sales of \$340.5 million for the amount of the repayment due to the consumer-owned utilities for amounts over-collected in rates for fiscal years 2007 and 2008, as well as an amount to reduce the Lookback Amount. The Final ROD established amounts to be returned to consumer-owned utilities as computed based upon what had been charged consumer-owned utilities for IOU REP benefits in fiscal years 2007 and 2008 as compared with the revised IOU REP benefits for the same period. The \$340.5 million represents the \$256.8 million refund of amounts to be returned to customers over-collected in fiscal years 2007 and 2008, plus the effects of the \$67.2 million Lookback Amount applied in fiscal year 2008, and \$16.5 million collected in rates in 2003 for IOU benefits deferred. This adjustment had no net impact to net operating revenues as operations and maintenance expenses were also reduced by \$340.5 million.

As described in the WP-07 Supplemental Rate Case, the BPA administrator will designate the amount to be recovered from the IOUs and returned to each qualifying consumer-owned utility. These amounts will not reduce rates, but will be credits to

qualifying consumer-owned utilities as designated in the corresponding Final RODs. BPA will recognize the refund and reduced expense in the year it is applied, until the Lookback Amount is eliminated. These transactions are net revenue neutral as the same amount reduces both revenue and expense.

The Final ROD issued on Sept. 22, 2008, is pending interim approval from FERC which is expected in the next month. Once interim approval for fiscal year 2009 has been received, BPA has the authority to put into effect the new rates, the revised REP benefit and to apply the Lookback Amount. Once FERC grants final approval of the rates, there is a 90-day statutory window where the rates and issues related to the REP and Lookback Amount could be challenged in the Ninth Circuit Court.

5. DEFERRED CHARGES AND OTHER

As of Sept. 30 — thousands of dollars

	2008	2007
Special purpose corporations' trust funds	\$ 72,482	\$ 64,907
Derivative instruments	40,963	50,443
Spectrum Relocation fund	39,243	47,241
Energy receivable	11,687	18,314
Other	11,670	25,493
	\$176,045	\$206,398

Deferred charges and other include the following items:

- “Special purpose corporations' trust funds” are amounts held in separate trust accounts for the construction of transmission assets (See Note 8, Nonfederal Debt).
- “Derivative instruments” represents unrealized fair value gains from the derivative portfolio which includes physical power purchase and sale transactions,

power exchange transactions, interest rate swap transactions, and power and heat rate option contracts.

- The Commercial Spectrum Enhancement Act created the “Spectrum Relocation fund” to reimburse the costs of replacing radio communication equipment displaced as a result of radio band frequencies no longer available to federal agencies. Amounts received from the U.S. Treasury in connection with the Act are restricted for use in constructing replacement assets.
- “Energy receivable” is energy to be returned to BPA for prior transmission line losses and over delivery.
- “Other” is primarily Corps and Reclamation costs for generating assets not placed in service and also special purpose entities' deferred issuance costs.

6. FEDERAL APPROPRIATIONS

Appropriations consist primarily of the power portion of Corps and Reclamation capital investments that had been funded through Congressional appropriations and the remaining unpaid capital investments in the BPA transmission system, which were made prior to implementation of the Federal Columbia River Transmission Act of 1974, 16 U.S.C. 838(j). Federal appropriations exclude future capital replacements and irrigation assistance.

The Refinancing Act required that the outstanding balance of the FCRPS federal appropriations be reset and assigned market rates of interest prevailing as of Oct. 1, 1996. This resulted in a determination that the principal amount of appropriations should 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. Appropriations in the amount of \$6.6 billion were subsequently refinanced for \$4.1 billion. This adjustment was recorded as a capitalization adjustment in regulatory liabilities and is being amortized over the remaining period of repayment.

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, in lieu of Congressional appropriations, BPA directly funds most operation and maintenance expenses as well as 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. Federal appropriations may be paid early without penalty.

The weighted average interest rate was 6.6 percent on outstanding appropriations as of Sept. 30, 2008.

MATURING FEDERAL APPROPRIATIONS

As of Sept. 30 — thousands of dollars

2009	\$	9,889
2010		3,784
2011		21,232
2012		24,622
2013		18,250
2014 and thereafter		4,180,084
		\$ 4,257,861

7. BORROWINGS FROM U.S. TREASURY

At Sept. 30, 2008, of the total \$2.2 billion of outstanding bonds, \$725.5 million were conservation and renewable resource loans and grants (including Corps, Reclamation and U.S. Fish and Wildlife Service capital investments). The weighted average interest rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently by BPA. As a result, the fair value of BPA U.S. Treasury borrowings exceeded the carrying value by approximately \$110 million and \$94 million, based on discounted future cash flows using agency rates offered by the U.S. Treasury as of Sept. 30, 2008, and 2007, respectively, for similar maturities.

The weighted average interest rate on outstanding U.S. Treasury borrowings was 5.2 percent and 5.4 percent as of Sept. 30, 2008, and 2007, respectively.

MATURING DEBT

As of Sept. 30 — thousands of dollars

2009	\$	440,400
2010		365,000
2011		325,000
2012		265,000
2013		122,800
2014 through 2037		667,700
		\$ 2,185,900

8. NONFEDERAL DEBT

PROJECTS FINANCED WITH NONFEDERAL DEBT

As of Sept. 30 — thousands of dollars

	2008	2007
Terminated nuclear facilities:		
Nuclear Project No. 1	\$ 1,863,790	\$ 1,938,640
Nuclear Project No. 3	1,811,025	1,909,430
Trojan	—	8,195
Terminated nuclear facilities	3,674,815	3,856,265
Nonfederal generation:		
Columbia Generating Station	2,359,765	2,327,420
Cowlitz Falls	132,880	137,810
Nonfederal generation	2,492,645	2,465,230
Lease financing program	245,132	170,657
Sponsored conservation:		
CARES	18,345	20,520
Tacoma	11,005	12,315
Emerald	205	441
Sponsored conservation	29,555	33,276
Northern Wasco	24,725	25,625
	\$ 6,466,872	\$6,551,053

BPA has acquired all or part of the generating capability of three nonoperating nuclear projects. These projects are 100 percent of Energy Northwest Nuclear Project No. 1, 70 percent of Nuclear Project No. 3, and 30 percent of the Trojan project owned by Eugene Water and Electric Board, Portland General Electric and PacifiCorp. The contracts to acquire the generating capability of the nonoperating nuclear projects require BPA to pay all or part of the projects' annual budgets, including maintenance expense and debt service on bonds issued by nonfederal entities. Project 1 and Project 3 were terminated prior to completion. PGE continues to decommission the Trojan project.

BPA acquired all of the generating capability of CGS nuclear generating project (formerly Project 2) and Cowlitz Falls hydro project and agreed to pay the maintenance and debt service costs.

The underlying debt for these Energy Northwest obligations (comprising terminated nuclear facilities and nonfederal generation) matures through 2024 with interest rates that are primarily fixed at rates between 3.6 percent and 7.3 percent.

Under the Lease Financing Program, BPA consolidates special purpose corporations that issue debt to and receive advances from nonfederal sources. Northwest Infrastructure Financing Corporation (NIFC) issued taxable bonded debt of \$119.6 million. NIFC II has

received advances of \$90 million under a fully utilized line of credit with Citibank. NIFC III has received advances of \$35.5 million as of Sept. 30, 2008, and has irrevocable commitments to receive additional advances of \$73.8 million under a \$200 million line of credit with JPMorgan Chase. The bonds and bank credit facilities are included in nonfederal debt in the accompanying Combined Balance Sheets. The debt matures through 2034 with interest rates that are primarily fixed at rates between 4.2 percent and 6.2 percent. The weighted average interest rate was 5.2 percent on the NIFCs' outstanding debt as of Sept. 30, 2008.

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.

BPA acquired the generating capacity of Northern Wasco hydro project which was terminated prior to completion.

Related assets for operating projects are included in nonfederal generation. Nonoperating projects are included in regulatory assets.

Nonfederal debt includes both operating and nonoperating projects. BPA recognizes expenses for these projects based upon total project cash funding requirements, which include debt service and operating and maintenance expenses. BPA recognized operating and maintenance expense for these projects of \$249 million, \$290 million and \$243 million in fiscal years 2008, 2007 and 2006, respectively, which is included in operations and maintenance in the accompanying Combined Statements of Revenues and Expenses. Debt service for the projects of \$479 million, \$343 million and \$338 million for fiscal years 2008, 2007 and 2006, respectively, is reflected as nonfederal expense in the accompanying Combined Statements of Revenues and Expenses.

The fair value of Energy Northwest debt exceeded recorded value by \$37 million and \$303 million as of Sept. 30, 2008, and Sept. 30, 2007, respectively. The valuations are based on

discounted future cash flows using interest rates for similar debt which could have been issued at Sept. 30, 2008, and Sept. 30, 2007, respectively. The weighted average interest rate was 5.3 percent for the Energy Northwest Columbia Generating Station, Nuclear Project No. 1, and Nuclear Project No. 3 portion of outstanding nonfederal debt as of Sept. 30, 2008.

MATURING NONFEDERAL DEBT

As of Sept. 30 — thousands of dollars

2009	\$ 284,469
2010	286,097
2011	281,149
2012	439,721
2013	527,685
2014 and thereafter	4,647,751

\$6,466,872

9. OTHER LIABILITIES

IOU EXCHANGE BENEFITS

As a result of the Ninth Circuit Court rulings, in fiscal year 2008 the associated liability and regulatory asset for the Settlement Agreements were reduced to zero (See Note 4, Residential Exchange Program).

In fiscal year 2008, recognizing the importance of rate relief for the Northwest customers, BPA offered regional customers agreements that would provide interim monetary payments in advance of the final decisions reached in the WP-07 Supplemental Rate Case. One set of these agreements, referred to as Interim Agreements, provided certain IOUs with temporary REP benefits for their residential and small farm consumers. These payments were provided on an interim basis only, and were subject to true-up to the amount of REP benefits for FY 2008 as determined in BPA's WP-07 Supplemental Rate Case. BPA paid the IOUs interim payments of

\$110.4 million under the Interim Agreements. BPA determined in the Final ROD for the WP-07 Supplemental Rate Case that the IOUs were entitled to \$180 million in REP benefits for FY 2008. The true-up amount for the IOUs is, therefore, \$69.6 million. Pursuant to a provision in the Interim Agreements, BPA will not make

the true-up payment to the IOUs until BPA receives final approval of the WP-07 Supplemental Rates from FERC, and any subsequent legal challenges to BPA's final Record of Decision for the WP-07 Supplemental Rates, if any, are resolved.

DEFERRED CREDITS

As of Sept. 30 — thousands of dollars

	2008	2007
Customer reimbursable projects	\$ 209,367	\$ 233,849
Direct-service industries' benefits	173,207	226,464
Generation interconnection agreements	157,505	69,110
Third AC intertie capacity agreements	107,285	110,350
Fiber optic leasing fees	42,594	46,301
Federal Employees' Compensation Act	34,478	37,241
Settlements	28,500	33,500
Capital leases	18,461	19,020
Derivative instruments	15,486	2
Other	10,616	15,795
	\$ 797,499	\$ 791,632

Deferred credits include the following items:

- "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, the revenue is recognized over the life of the asset once the corresponding asset is placed in service.
- "Direct-service industries' benefits" reflect a contractual liability to Northwest aluminum companies and one paper mill for fiscal years 2009 through 2011. The contracts became effective on Oct. 1, 2006, and continue in effect through Sept. 30, 2011.
- "Generation interconnection agreements" are generators' advances held as security for requested new network upgrades and

interconnection. These advances accrue interest and will be returned as credits against future transmission service on the new or upgraded lines.

- "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.
- "Federal Employees' Compensation Act" reflects the actuarial estimated amount of future payments for current recipients of BPA's worker compensation benefits.
- "Settlements" reflect payments due customers or counterparties as a result of contractual settlement agreements and

proposed settlements stemming from litigation (See Note 10, Commitments and Contingencies).

- “Capital leases” represent BPA’s long-term portion of capital lease liabilities for Goshen-Drummond and Lower Valley-Teton transmission lines.
- “Derivative instruments” is the unrealized fair value loss of the derivative portfolio which includes physical power purchase and sale transactions, and interest rate swap transactions.
- “Other” consists of miscellaneous liabilities not identified above.

10. COMMITMENTS AND CONTINGENCIES

FIRM PURCHASE POWER AND SALE COMMITMENTS

As of Sept. 30 — thousands of dollars

	PURCHASES	SALES
2009	\$ 41,545	\$ 2,011,391
2010	26,979	2,115,681
2011	24,473	2,117,513
2012	56,852	2,036,206
2013	56,852	2,040,650
	\$206,701	\$10,321,441

Subscription contracts are the basis for the contractual relationship between BPA and its consumer-owned utilities. These contracts expire by Sept. 30, 2011. BPA enters into commitments to sell expected generation for future dates. If BPA forecasts a resource shortage it enters into commitments to purchase power for future dates. BPA records revenues and expenses associated with these sales and purchases in the periods that power is delivered or received.

ENDANGERED SPECIES ACT

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 Fisheries Service and the U.S. Fish and Wildlife Service in furtherance of the ESA.

In May 2008 BPA, the Corps and Reclamation signed 10-year agreements with four Northwest tribes, Columbia River Inter-Tribal Fish Commission (CRITFC), the State of Idaho and the State of Montana. A fifth tribe is scheduled to sign the agreements in early November 2008. These agreements that are collectively referred to as the Columbia Basin Fish Accords provide for BPA to fund up to approximately \$933 million over 10 years, enabling the tribes and states to continue existing programs and to implement new priority fish projects.

In return, the tribes and states commit to achieving biological objectives linked to meeting the federal agencies’ statutory requirements. The parties also agree that the federal government’s requirements under the ESA Clean Water Act and Northwest Power Act are satisfied for the next 10 years. The agreements specifically resolve, for these parties, ESA litigation pending before the U.S. District Court. BPA will record a liability when performance of all material conditions is met related to the executed individual contracts associated with the Columbia River Fish Accords.

IRRIGATION ASSISTANCE – SCHEDULED DISTRIBUTIONS

As of Sept. 30 — thousands of dollars

2009	\$ 7,274
2010	—
2011	—
2012	1,206
2013	60,027
2014 and thereafter	615,183

\$ 683,690

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. Future irrigation assistance payments ultimately could total \$684 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 to the extent the costs have been determined to be beyond the ability of the irrigators 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. Irrigation assistance excludes \$40.3 million for Teton Dam, which failed prior to completion, and BPA has no obligation to recover these costs.

ADDITIONAL POST-RETIREMENT CONTRIBUTIONS – FUTURE CONTRIBUTIONS

As of Sept. 30 — thousands of dollars

2009	\$ 30,554
2010	31,195
2011	32,142
2012	32,791
2013	33,480

\$ 160,162

All fiscal years are estimates and subject to change.

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 to ensure that 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 \$18 million, \$21 million and \$23 million to the U.S. Treasury during fiscal years 2008, 2007 and 2006, respectively. BPA calculates the additional contribution based upon employee plan participation and the extent to which the particular plans are under-funded. BPA records these amounts as expenses during the year in which they are paid.

1989 LETTER AGREEMENT

In 1989 BPA 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.

NUCLEAR INSURANCE

BPA is a member of the Nuclear Electric Insurance Limited, 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 \$7.1 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is \$14.4 million. For the Business Interruption and/or Extra Expense Insurance policy, the maximum assessment is \$4.3 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 may be identified as potential responsible parties. Costs associated with cleanup of sites are not expected to be material to the FCRPS' financial statements and would be recoverable through rates. As such, no liability has been recorded.

LITIGATION

Southern California Edison

Southern California Edison (SCE) had 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 challenged: 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 alleged violated its power sales contract (Rate Adjustment Claim); and 3) BPA's termination of its performance under the contract due to SCE's nonperformance (Termination Claim).

With respect to the Conversion Claim, SCE's complaint sought damages in the amount of approximately \$186 million. 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. The settlement identified three conditions precedent to final resolution: 1) SCE must obtain approval of the settlement from the California Public Utilities Commission; 2) BPA must complete a public review and comment process and subsequently reaffirm the settlement; and 3) BPA must receive a final resolution of its refund liability, if any, in the California refund proceedings. The first two conditions have been met. When the third condition is met, BPA will pay SCE \$28.5 million plus interest.

In fiscal year 2006, BPA recorded a liability for the settlement with SCE because it determined that it was "probable" that the two conditions would occur and cause the proposed agreement to become final. BPA established an offsetting regulatory asset for the liability as the costs will be collected in future rates.

The Rate Adjustment Claim was settled with an agreement by BPA to pay SCE \$13.4 million. BPA deposited these funds into escrow for disbursement to SCE pending the satisfaction of certain conditions, which have since occurred. BPA disbursed funds to SCE in October 2007.

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 fiscal years 2007-2011.

On Sept. 28, 2005, Alcoa, Inc., a BPA direct-service industrial customer, filed a petition for

review in the United States Court of Appeals for the Ninth Circuit challenging the DSI ROD. On the same day, the Pacific Northwest Generating Cooperative, a consortium of BPA public consumer-owned utilities, filed a separate petition for review. In August 2006, additional petitions were filed challenging 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. Additionally, in October 2006, petitions were filed challenging BPA's execution of a surplus power sales contract to serve Port Townsend Paper, a small direct-service industrial customer. The various petitions were consolidated, and briefing is complete. Oral argument was held on Nov. 7, 2007. The parties await a decision from the court. No liability has been recorded.

California Parties' Refund Claims

In a case relating to FERC proceedings concerning the California energy crisis of 2000-2001, in September 2005 the Ninth Circuit Court issued an opinion holding that FERC lacks authority under the Federal Power Act to order non-jurisdictional entities such as BPA to make refunds to counterparties. Subsequently, three California IOUs, the California Electricity Oversight Board, and the California Attorney General's Office on behalf of the California Department of Water Resources filed administrative claims with BPA under the Contract Disputes Act in the Court of Federal Claims (CFC). The claims 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. BPA denied the claims, and the California parties subsequently filed complaints with respect to their claims in the United States Court of Federal Claims. In addition, the California parties filed a writ of certiorari in the above referenced Ninth Circuit Court case at the United States Supreme Court. Argument on the motion was heard on June 24, 2008, and the Court denied the motion. BPA filed answers in October 2008 in the CFC litigation. BPA cannot determine at this time whether the claimed amount will ultimately be upheld. BPA has engaged in settlement

discussions prior to the filing of these suits and continues to be open to settlement. There are a number of legal issues that will eventually be resolved by the courts that will determine whether any amounts will be accrued. At present no liability is recorded.

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. 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 pending matters will not have a materially adverse effect on the FCRPS' financial position or results of operations for fiscal year 2008.

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

REPORT OF INDEPENDENT AUDITORS



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, 2008, and 2007, and the results of its operations and its cash flows for each of the three years ended September 30, 2008, and the changes in its capitalization and long-term liabilities for each of the two years ended September 30, 2008, 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 30, 2008

FEDERAL REPAYMENT

REVENUE REQUIREMENT STUDY

The revenue requirement study demonstrates repayment of federal investment, and it reflects revenues and costs consistent with BPA's 2007 Final Wholesale Power Rate Proposal in July 2006 for fiscal years 2007 and 2008 (see WP-07-FS-BPA-02) and consistent with BPA's WP-07 Supplemental Proposal filed in September 2008 for fiscal year 2009 (see WP-07-FS-BPA-10), and the 2008 Final Transmission Rate Proposal in April 2007 for fiscal years 2008 through 2009 (see TR-08-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 FERC 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 operating and maintaining the power system including payments to fully fund post-retirement benefits provided to employees associated with the operation of the FCRPS.
2. Pay the cost of obtaining power through purchase and exchange agreements (nonfederal projects) that Bonneville is obtaining under capitalized lease-purchase agreements.
3. Pay interest on and repay outstanding U.S. Treasury borrowings 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.

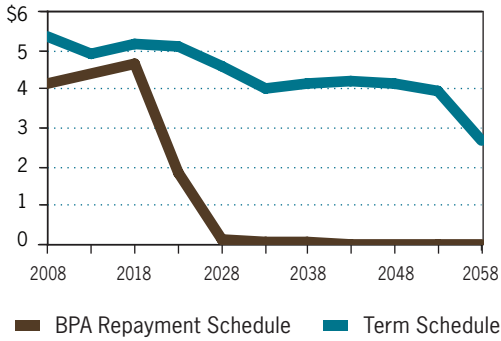
REPAYMENT OF FCRPS INVESTMENT

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 (35 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

UNREPAID FEDERAL GENERATION INVESTMENT

Includes future replacements — billions of dollars

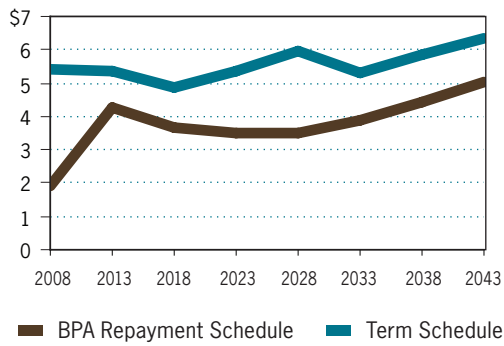


through 2008 is scheduled to be returned to the U.S. Treasury within its repayment period and ahead of due dates.

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.

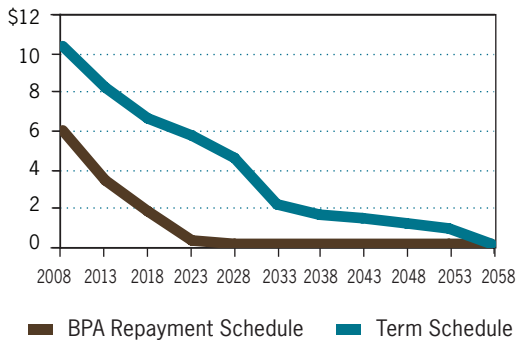
UNREPAID FEDERAL TRANSMISSION INVESTMENT

Includes future replacements — billions of dollars



UNREPAID FEDERAL INVESTMENT

Excludes future replacements — billions of dollars



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Bonneville Power Administration
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