BONNEVILLE POWER ADMINISTRATION

2007
Annual Report

Serving the Northwest for 70 years

Cover photo:

Mules served as graders in the original 1940 construction of what is now J.D. Ross Substation in Vancouver, Wash.

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On Aug. 20, 2007, BPA celebrated its 70th anniversary. Highlights of BPA's seven decades of service to the Northwest can be found throughout this report.

Dear Mr. President:

It was a great year. Despite below average water, we ended the year exceeding our start-of-year financial targets. I am also happy to add that there was no need for an increase in our wholesale power or transmission rates for fiscal year 2008.

Our recovery from the dark days of the West Coast energy crisis is no aberration. For the past five years, the Bonneville Power Administration has maintained its strong and increasingly solid return to financial stability. Such resilience has always been a hallmark of BPA, and I believe our ability to change and respond to external conditions reflects an underlying strength of the agency.

We have worked hard for this stability. We have cut costs, lowered rates and rebuilt our financial reserves. Not only has this effort given us greater operational and financial certainty, but it has put us in a better position to address longer-term challenges.

BPA's stability is increasingly important because the Federal Columbia River Power System, with its reliance on hydropower, is quite possibly the most valuable electricity resource in the nation given that it produces no emissions and has extremely low embedded costs. It is, however, a finite resource, and our customers and constituents have growing needs. Our responsibility is to

Steve Wright, BPA Administrator

ensure that the benefits of the federal system are equitably shared consistent with the law throughout the region.

This past year, with release of our Long-Term Regional Dialogue Policy, we took a major step toward securing those benefits for the Pacific Northwest well into the future and creating the certainty that will enable infrastructure investments that are necessary for the Pacific Northwest economy to grow. The policy culminated five years of discussions on how BPA will market power to the region after Sept. 30, 2011. That's when current power sales contracts with our preference customers expire.

Our goal now is to complete the rate design and product development processes so that we can begin putting new 20-year contracts in place by the end of 2008. Such contracts will go far in securing the long-term financial stability and certainty that will ensure BPA can meet its responsibilities to U.S. taxpayers as well as to Pacific Northwest ratepayers.

We also are working on a parallel path to determine an equitable level of benefits consistent with the law that we will provide to investor-owned utilities for their residential and small-farm consumers and to our remaining direct-service customers.

As the owner and operator of the bulk of the region's high-voltage transmission grid, we have continued to shore up the reliability of the regional transmission system with investments to maintain and enhance these assets. This past year, we also piloted new ways to relieve congestion on the grid, both preserving reliable operation and enabling commercial transactions to proceed without disruption.

We have collaborated extensively with the Northwest states, Columbia River tribes and others to develop a multi-year plan, grounded in solid science, to address endangered salmon and steelhead. There has been progress, but much more progress is needed if we are to achieve a regional accord on species recovery.

This year we also had the future very much in mind. We worked with the Northwest Power and Conservation Council and several other Northwest leaders to develop a Wind Integration Action Plan aimed at integrating as much as 6,000 megawatts of new wind power into the Pacific Northwest energy portfolio. The action plan will help the Northwest take advantage of an abundant source of renewable energy. We ourselves added 50 megawatts of capacity from wind resources to our power portfolio this year.

We also met a very aggressive target of capturing 52 average megawatts of energy efficiency and provided $1.7 million in grants for projects designed to realize the potential for intermittent renewable power such as wind, wave and tidal power. I am also proud of the fact that we added a new strategic business objective to our long-term strategic plan. It calls for developing cost-effective policies that lead to reductions in greenhouse gasses.

It is gratifying that our efforts have been acknowledged by those we serve. Last year, we received the highest satisfaction scores from customers, constituents and tribes in more than a decade of conducting annual surveys. This year, we maintained that high level of performance with scores that were as good as or better than fiscal year 2006, despite the challenges and work load we faced in 2007.

Finally, this August, BPA turned 70, and we are celebrating our seven decades of service to the Pacific Northwest by highlighting in this annual report some key events in our long and proud history.

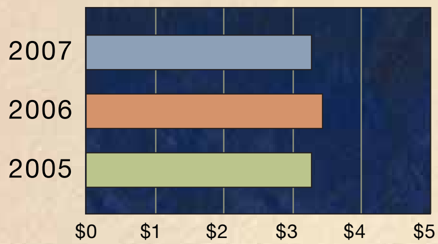
Sincerely,

Stephen J. Wright

Stephen J. Wright
Administrator and CEO

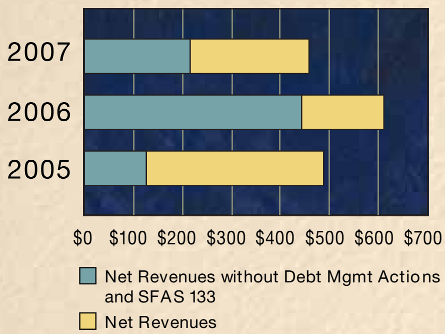
FINANCIAL RESULTS

Operating Revenues
billions of dollars

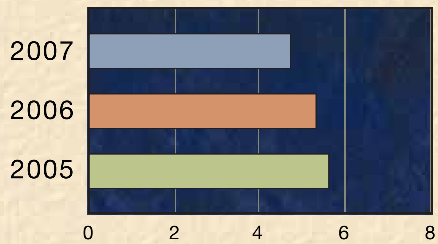


Operating Expenses
billions of dollars

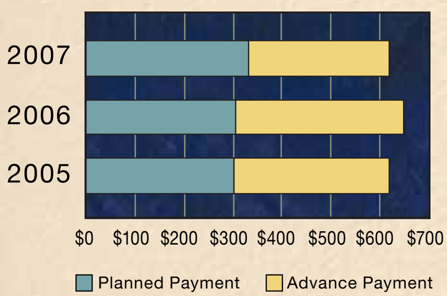
Net Revenues With and Without Debt Management Actions and SFAS 133
millions of dollars



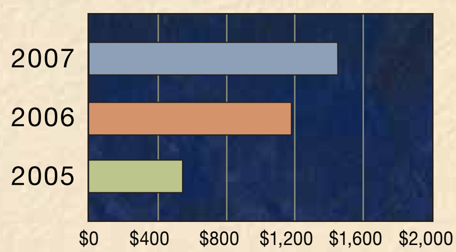
Nonfederal Debt Service Coverage Ratio
times covered



Status of Treasury Principal Repayment
millions of dollars



Financial Reserves
millions of dollars



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

This year marks the 24th year in a row that the Bonneville Power Administration has made its full payment to the U.S. Treasury. Even through the challenging times of the West Coast energy crisis, BPA met its obligations to U.S. taxpayers on time and in full.

Nothing, we believe, provides greater testimony to BPA's strength and resilience. This strength is an important asset in a region that depends on hydropower and the vagaries of weather. If the downside of the region's federal hydro system is unpredictable good and bad water years, the upside is that hydropower is turning out to be one of the nation's most valuable resources. It is clean. It is renewable. And, it is comparatively low cost.

Finance

Revenues good despite water year

Good financial results are a result of a combination of good water, high market prices, cost control and conservative financial management. This year, we had below average water and moderate market prices, but continued cost management helped contribute to a successful year despite below average water. The January-July runoff measured at The Dalles, Ore., was 95.7 million acre-feet of water, or 89 percent of the 30-year average.

In spite of these factors, financial results for fiscal year 2007 exceeded our agency expectations, although they fell short of fiscal year 2006's record results. Fiscal year 2007 net revenues were $457 million on total operating revenues of $3.3 billion, compared to $611 million for the previous year on total operating revenues of $3.4 billion. Adjusted for debt management actions and the effects of mark-to-market accounting, BPA's modified net revenues totaled $217 million compared to $445 million in fiscal year 2006 and exceeded our agency target range of $50 million to $150 million.

Treasury payment included prepayment

During fiscal year 2007, total payments to the U.S. Treasury were $1.045 billion. This included a prepayment of $289 million to retire a portion of our Treasury debt early as part of our Debt Optimization Program. Under this program, BPA and Energy Northwest have been extending the maturities of Energy Northwest bonds as they come due. Instead of paying Energy Northwest debt, BPA prepays federal debt to replenish BPA's Treasury borrowing authority. Energy Northwest operates the region's only nuclear plant, and BPA markets the power from that plant.

In April, BPA and Energy Northwest closed a $548 million bond offering, which included some bonds for the purposes of the Debt Optimization Program and other bonds refinanced for savings. BPA will realize about $19.1 million on a net present value basis due to the latter. Overall, total restored borrowing authority resulting from the Debt Optimization Program is about $1.5 billion since the program began in 2001.

Good bond ratings sustained

This past spring, Fitch Ratings retained its AA- rating of Energy Northwest bonds

1930s

The Bonneville Project Act, signed into law in August 1937, created the Bonneville Power Administration. BPA's first power rates — approximately 2 mills per kilowatt-hour — stayed in place for 27 years. They were famously referred to as "postage stamp" rates because distance did not influence the rate. In 1938, BPA energized its first transmission line, a single-current line from Bonneville Dam to Cascade Locks, 3.5 miles away. Two years later, BPA energized the 238-mile Bonneville-Grand Coulee line, setting the stage for a high-voltage transmission grid that would grow to encompass over 15,000 circuit miles.

backed by BPA, but upgraded the outlook of those bonds from stable to positive, following the rating agency's annual review of BPA's financial condition. The two other rating agencies also reviewed the credit of Energy Northwest BPA-backed bonds. Moody's and Standard & Poor's each reaffirmed its rating of Aaa and AA-/Stable, respectively.

Financial plan update announced

BPA announced in the Regional Dialogue Policy that it will look broadly at long-term financial policy issues in a financial plan update. The update will cover a number of things, including access to capital and the appropriate Treasury Payment Probability standard for rate setting. We intend to complete this financial plan update before we sign new long-term power sales contracts. We will provide for public involvement on all of these issues.

Financing agreement helped borrowing

In June, BPA entered into a third-party financing transaction with a nonfederal party. BPA established a master lease agreement for various transmission assets. We anticipate continued implementation of third-party financing for needed investments on our transmission network. Third-party financing is expected to preserve $100 million to $150 million a year in Treasury borrowing authority.

U.S. Army Corps of Engineers

President Franklin D. Roosevelt dedicated Bonneville Dam on Sept. 28, 1937.

Rates

Year opened with lower power rate

BPA opened fiscal year 2007 lowering the base average wholesale power rate 3 percent. The average base rate for priority firm power of $27.33 per megawatt-hour took effect Oct. 1, 2006, and it will remain at that level for fiscal year 2008. The priority firm rate applies to qualifying public utility districts, municipalities and consumer-owned electric cooperatives that are entitled to a statutory preference and priority in the purchase of available Federal Columbia River Power System power.

The agency's base power rates for fiscal years 2007-2009 can be increased or decreased each year based on the previous year's financial results. A Cost Recovery Adjustment Clause could be triggered for an upcoming year, resulting in a rate increase sufficient to increase revenues up to $300 million if the current year's financial results are sufficiently low. A Dividend Distribution Clause could be triggered for an upcoming year, resulting in a rate reduction if current year financial results are sufficiently high. Neither adjustment was triggered for fiscal year 2007 or 2008 rates.

Transmission rate case completed

In January, most of BPA's transmission customers signed a settlement agreement addressing the agency's transmission rates for fiscal years 2008-2009. Because of the agreement, we were able to execute an expedited 90-day transmission rate case. Customers saw little or no change in their aggregate rates for BPA transmission service starting Oct. 1, 2007.

Power

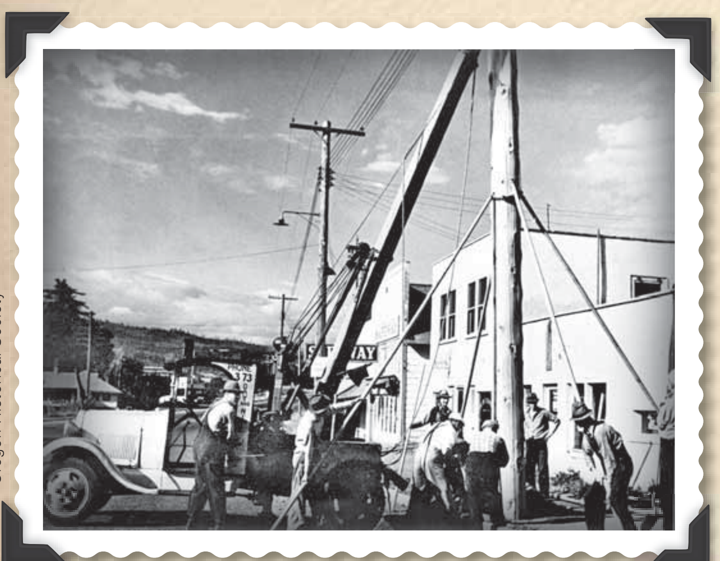
Regional Dialogue Policy released

The year's defining event for BPA was release of our Long-Term Regional Dialogue Policy and record of decision in July. The release capped five years of discussions on BPA's future role in power marketing beyond 2011, when current power sales contracts expire.

The policy includes a new tiered rate approach, with the Tier 1 rate based on the cost of the existing federal system with little augmentation. If preference customers choose to buy more power from BPA beyond their Tier 1 designation, this power will be sold at a Tier 2 rate set to fully recover BPA's costs of securing additional resources to serve this load.

By defining the amount of power that will be available at our Tier 1 rate, our intent is to provide the clarity utilities and other resource developers need to make decisions about developing or acquiring new power resources. We believe this will give the long-term certainty necessary for ensuring the major infrastructure investments the region will need to make.

A low and stable Tier 1 rate also will greatly enhance BPA's financial stability and will significantly reduce future risk to BPA's ability to make its payments to the U.S. Treasury. Long-term take-or-pay commitments from customers add further assurance that BPA will be able to make those payments.



Oregon Historical Society

BPA's first transmission line from Bonneville Dam to Cascade Locks, Ore., began delivering power on July 9, 1938.

We are now working on implementation details such as developing the long-term tiered rates methodology, which will be followed by a separate process to set post-2011 rates. Our goal is to sign new 20-year preference power sales contracts in late 2008. We also plan to offer contracts to all of our customers — public agencies, investor-owned utilities and direct-service industries — at the same time, so we can provide certainty about the value each group may expect to receive from BPA's system.

Ninth Circuit ruled on Residential Exchange

In May, the U.S. Ninth Circuit Court of Appeals issued opinions in two lawsuits that included, among other subjects, issues related to Residential Exchange Program settlements BPA had executed in 2000 with investor-owned utilities. The Residential Exchange Program was established by the Northwest Power Act to provide rate relief to Pacific Northwest residential and small-farm customers served by qualifying utilities that have high average system costs. Most of these utilities are investor owned. The rate relief provides a form of access to the benefits of the Federal Columbia River Power System. At the same time, Congress intended to limit the financial exposure of publicly owned utilities to certain costs occurring under the Act.

The suits were brought primarily by publicly owned utilities. The court concluded that the Residential Exchange Program settlements were inconsistent with the Northwest Power Act and that BPA improperly allocated costs of the settlement to its priority firm preference rate.

Following the court's decisions, BPA suspended the payments and began facilitating discussions between investor-owned utilities and public customers to identify areas of agreement that would expedite regional resolution of issues consistent with the law. While there is not yet consensus, all parties appear to favor a regional solution, and this is providing an impetus for the discussions. At the same time, BPA is proceeding to implement a new Residential Exchange Program to begin in fiscal year 2009. BPA may propose revisions to the Average System Cost Methodology and will review a statutory rate test methodology that protects consumers served by publicly owned utilities from certain costs. Any agreement the parties reach would inform these processes and would likely help bring more timely rate relief. In August, BPA held the first of several workshops to discuss these processes.

Resource adequacy standards developed

The Pacific Northwest continues to work toward ensuring adequate electricity resources for its future. The Regional Dialogue Policy will help in that it gives customers a clear idea of what they can expect from BPA so that they have time to decide how they will secure additional resources if needed.

In fiscal year 2006, BPA and the Northwest Power and Conservation Council jointly initiated the Pacific Northwest Resource Adequacy Forum, which includes regional energy leaders. The forum has been working to forge a set of consensus-based energy and capacity adequacy standards for the region. As part of this effort, in fiscal year 2007, the

1940s

BPA rose to new challenges during the war years of 1941 to 1945, delivering more electricity than all of the other power systems in the region combined in the preceding 50 years. By 1945, BPA's high-voltage transmission system was the second largest power grid in the nation. The shift to war loads required many changes in the construction of lines radiating from the main grid, but every requirement was met on schedule even with the loss of many skilled workers to the armed forces. Some 1,155 BPA employees were called into service, with 12 dying in action.

1950s

A golden age of technological achievement opened. BPA developed the nation's first microwave system for communicating signals to the relays that trigger equipment-protection devices. BPA engineers also succeeded in developing a program for calculating power flows with digital computers, which proved to be faster, more accurate and more flexible than previous analog approaches. Many BPA inventions and developments went on to become standards for the rest of the industry.

Council adopted the Energy Adequacy and Pilot Capacity Adequacy Standards along with a voluntary implementation plan.

The new standards promote a more detailed assessment of loads and resources and how they might be affected by temperature, precipitation, outages and other factors. Taking these factors into account, the standards set targets and metrics to measure both the energy and capacity capabilities of the Northwest's electric energy system.

As part of the Regional Dialogue power contracts, BPA will require that customers provide annual forecasts of loads and resources. This information will be used to facilitate regional resource adequacy assessments. We also expect our future customer contracts to include terms that define which parties will have responsibility to serve load growth.

Transmission

BPA met new reliability standards

Reliability was a keynote theme for the year, not only in the nation, but in the region as well. BPA has either complied with the 83 Federal Energy Regulatory Commission reliability standards that went into effect in June or has self-reported and filed mitigation plans for areas of noncompliance, which are primarily related to documentation. The mitigation plans have been approved by the Western Electricity Coordinating Council. BPA completed the first group of mitigation actions in August. We also worked with our utility customers and WECC to develop a

Early survey crews mapped out the framework of today's Northwest transmission grid.

comprehensive and consistent approach to registering Northwest utility functions with the North American Electric Reliability Corp. as mandated by FERC's Order No. 672.

In May, BPA submitted a "strawman proposal" to FERC showing how we intended to comply with nine transmission planning principles in FERC's Order No. 890. Although FERC does not have jurisdiction over BPA for this purpose, BPA continued its practice of voluntarily complying with FERC's direction. We developed our proposal in consultation and coordination with BPA customers, ColumbiaGrid (the regional transmission planner) and WECC. We will refine our proposal based on ongoing FERC guidance and further discussions with other regional parties, including ColumbiaGrid.

Long-term service addressed

During the year, BPA organized a Transmission Issues Policy Steering Committee made up of BPA and customer representatives to create principles and guidance for addressing access to long-term firm transmission service and, if needed, the development of infrastructure to provide that service. The goal is to work with transmission customers to clarify how their post-2011 power purchase agreements relate to their current transmission rights, what they need to do to access BPA transmission, and who pays for new network transmission infrastructure. BPA is fostering a regional planning approach to ensure that the appropriate transmission facilities are built when they are needed.

The Steering Committee reviewed a new approach to allocating transmission expansion costs and financing commercial infrastructure for transmission network upgrades. For facilities solely within BPA's service area, BPA proposed to explicitly consider benefits to all transmission ratepayers of a proposed facility's contributions to reliability, expected future system uses and other economic benefits. Costs associated with these benefits would be allocated to participating transmission ratepayers.

New revenues from a facility would be used to cover carrying costs of the remaining portion of a project to avoid incremental rate increases for all transmission customers. We believe this approach is consistent with FERC Order No. 890. Customers and state public utility commissions responded positively to a draft policy issued for comment early in the year. We are working out details and quantification methods before we issue a policy.

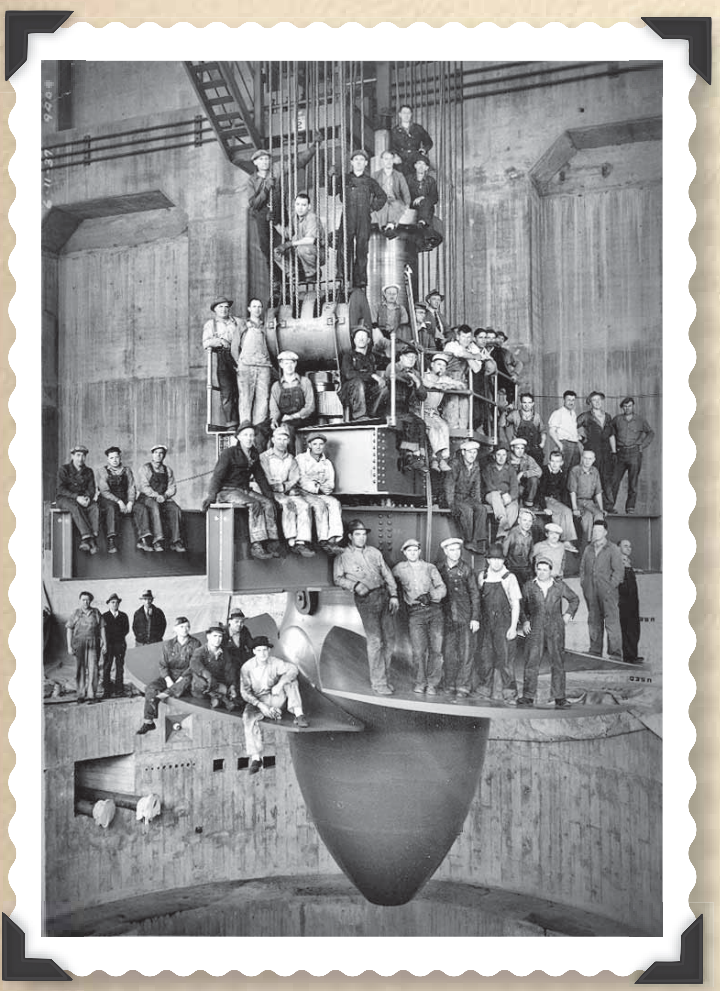
BPA also is working on a new approach to effectively deal with our large queue of requests for transmission service. Under the approach, we are advancing a concept of a network open season for all firm pending network transmission requests in the early part of calendar year 2008. Under the current concept, participants would sign binding precedent agreements, which would convert to standard contracts on satisfaction of certain conditions. Because of the large number of requesters in the queue for transmission, it has proven a formidable challenge to analyze each individual generator's impact on the system.

Rather than continue with this approach, BPA proposes to do "cluster" studies to determine impacts on network flow based on the participants in the open season. We would work closely with ColumbiaGrid to assure optimum expansion of regional transmission service, not just for those commitments developed through the open season process. As with allocating costs of network expansion, we are working on the details of this process.

Also, this year BPA became the second Western Interconnection utility to join the North American Transmission Owners and Operators Forum. The forum, chartered under the North American Electric Reliability Corp., provides a venue for transmission owners and operators to identify and disseminate industry best practices for reliable operations. The other Western Interconnection utility involved in the forum is British Columbia Transmission Corp.

Pilot program aimed to reduce congestion

BPA continued its work to manage transmission congestion by conducting a reliability redispatch program this past summer. The pilot called for alleviating congestion on specific paths by directing specific generators to adjust their output



Workers posed on a Bonneville Dam turbine.

based on voluntary bids from generators. As part of an interim measure used with the pilot, BPA has not accepted new hourly transmission reservations on a congested path for two hours after that path exceeds its posted operating transfer capability.

We also are developing better network flow forecast tools to allow BPA to restrict nonfirm and hourly firm transmission schedules that would cause or contribute to system reliability problems on specified transmission paths. While preliminary indications are positive, the results of the pilot will be evaluated more thoroughly in the coming months.

Transmission upgrades continued

Many of the year's construction projects are the result of requests to integrate wind into the regional grid. BPA has responded with line upgrades and relocations and new substations. These and other reliability projects, such as the Olympic Peninsula Reinforcement Project, are in various stages, ranging from environmental reviews to construction.

Scheduling automation enhanced

In spring 2007, BPA Transmission Services switched over to the wesTTrans Open Access Same-Time Information System. This is a Web-based transmission reservation system currently used by most electric utilities in the West. It allows greater automation of the complex long-term and short-term hourly transmission reservation and scheduling processes required to manage the trans-

1960s

An era of interconnection with other regions began thanks to a historic treaty with Canada and development of the interties that connect the Northwest with the Southwest. These interties, the largest transmission projects ever undertaken in the United States at the time, were hailed as engineering marvels. They took advantage of the fact that the Northwest and Southwest traditionally had different peaking times, winter and summer respectively, which allowed for the exchange of power and minimized each region's need to build resources.

1970s

With a burgeoning Northwest population, it was clear that hydropower alone could not meet future needs. This led to the Hydro-Thermal Power Program intended to augment federal hydropower with nonfederal thermal power. Concerns about an energy shortage and other issues set the stage for development of the Northwest Power Act. It was also the decade when BPA began real-time control with digital computer support for day-to-day system operations replacing the analog-supported manual system, thus enhancing operational decisions. And, in 1974, BPA became a self-financing agency through the Columbia River Transmission Act.

mission grid. Having a common platform for transmission reservations also provides significant efficiencies. BPA has developed most of the automation facilities resulting from this system and will develop the remaining computer capabilities when the North American Energy Standards Board completes automation protocols.

ColumbiaGrid signed first agreement

In March, BPA, along with other Northwest utilities, signed a Transmission Planning and Expansion Functional Agreement offered by ColumbiaGrid, the Northwest's independent regional transmission organization. The agreement established ColumbiaGrid as a regional planning entity to coordinate and produce a 10-year Northwest transmission plan on a biennial basis. BPA is a funding member of ColumbiaGrid development.

In April, BPA and other utilities signed a one-year near-term reliability services development agreement with ColumbiaGrid. Under the agreement, ColumbiaGrid will assist in regional efforts to increase the visibility of transmission system operating information available to operators. ColumbiaGrid also will participate in and evaluate BPA's reliability redispatch project for congestion management and recommend enhancements to existing scheduled outage coordination processes and new control area diversity exchange programs. ColumbiaGrid is focusing on those services that an independent entity with a system perspective broader than a single transmission owner could provide.

Bonneville Dam was built by the U.S. Army Corps of Engineers between 1933 and 1937.

In June, we formally asked ColumbiaGrid to coordinate regional electrical service planning for two proposed BPA transmission projects. The projects are the West of McNary Generation Integration Project along the Columbia River and the I-5 Corridor Reinforcement Project in western Oregon and Washington. ColumbiaGrid is expected to complete review of electrical plans of service for the West of McNary project by the end of this calendar year and for the I-5 reinforcement project in 2008. BPA will then complete environmental review and detailed design. We will offer commercial arrangements to transmission users before determining whether to proceed with each project.

Energy efficiency

BPA met aggressive targets

This fiscal year, BPA met an aggressive target to acquire 52 average megawatts of new energy efficiency. We are seeking to meet this target each year in the 2007-2009 rate period. Our target will increase to 60 or more average megawatts in 2010. We enhanced our energy efficiency initiatives implemented through our customer utilities and also increased incentives to achieve energy efficiency in industrial applications and non-lighting commercial loads. We provided additional contract technical advisors to our utility customers to recommend, in particular, opportunities for efficiency in commercial lighting. We also simplified and clarified certain reporting requirements for participating utilities.

We increased our budget for low-income weatherization assistance to a record $15 million for the fiscal year 2007-2009 rate period, an average increase of about $1.2 million a year over the fiscal year 2002-2006 rate period. The funds are allocated to the four Northwest states and Northwest tribes in our service territory. BPA funds are used in conjunction with existing state-run, low-income weatherization programs that follow Department of Energy Weather Assistance Program guidelines.

New program focused on appliances

In April, we launched a new energy efficiency program designed to capture up to 4.5 average megawatts of cost-effective conservation in the hard-to-reach commercial refrigeration sector. So far 60 utilities have signed up for the program, which is operated by Portland Energy Conservation, Inc. The program is designed specifically to reach commercial refrigeration loads in small rural communities, as well as to serve large supermarkets and grocery stores in urban areas. The program will continue through fiscal year 2009.

We also are looking to the long term. Energy efficiency is an important part of the recently released Regional Dialogue Policy. Through tiered rates, BPA will provide economic incentives for customers to pursue conservation.

"Bound for Glory"

In 1941, folk singer Woody Guthrie worked for BPA for 30 days — and wrote 26 songs, including "Roll On, Columbia."

New renewable energy

Wind potential promoted

The Northwest has the potential to bring on 6,000 megawatts of new wind generation in the next two decades. However, integrating intermittent resources, such as wind, into the regional grid poses challenges and costs that must be identified and addressed. To this end, BPA teamed with the Northwest Power and Conservation Council to sponsor development of a regional Wind Action Plan for integrating new wind energy into the Northwest's existing power system by 2024. The action plan, released in March, was the coordinated work of a broad group of Northwest energy experts, state leaders, public and investor-owned utility representatives, wind developers and environmental leaders.

Integration of wind on this scale into the Northwest's largely hydro-driven system will require investments in high-voltage transmission lines and new regulatory and utility cost-recovery policies. The potential is exciting, and we believe the challenges can be resolved. We are continuing work to make wind integration on this scale a reality.

More wind power purchased

In addition to wind integration initiatives, BPA negotiated a wind power purchase in fiscal year 2007. In October 2007, BPA signed a 20-year agreement to purchase 50 megawatts of capacity (which will translate into 15 megawatts or more of energy) from the Klondike Wind Power III project in Sherman County, Ore., under a contract with PPM Energy, Inc. This cost-competitive purchase will help us ensure an adequate power supply to meet customer needs in the years ahead.

This new acquisition also helps meet the renewable power targets set for the region by the Northwest Power and Conservation Council by increasing BPA's total renewable capacity supply by roughly 22 percent, from about 181 megawatts to 231 megawatts. In addition, this acquisition will help meet the 300 average megawatts needed to augment the Federal Base System to meet the needs of Tier 1 customers beginning in 2012.

Once the project is operational, which is expected by late 2007, electricity from Klondike III will be integrated into BPA's system and sold as Environmentally Preferred Power. Renewable Energy Certificates for Klondike III will be sold separately.

R&D processes stepped up

During the year, we initiated research, development and demonstration solicitation processes for fiscal years 2007 and 2008. Areas of interest for 2007 included transmission and renewable resources. Areas of interest for 2008 include transmission, energy efficiency, security technology and renewable resources.

In June we awarded $1.7 million in contracts to promote research and development of ways to help manage the intermittent

1980s

Passage of the Northwest Power Act brought new responsibilities to BPA, particularly in the areas of energy conservation and fish and wildlife. In this decade, BPA became a national leader in energy efficiency and changed the image of conservation from curtailment to one of preserving all the amenities by using energy more efficiently. Federal agencies also began a major overhaul of the hydro system to make it more fish friendly. Finally, BPA made a gut-wrenching but smart decision to call a stop to construction on two partially completed nuclear projects.

1990s

Wholesale deregulation came to the electrical energy industry. For the first time BPA faced competition as new independent energy marketers attracted BPA customers with lower prices. BPA responded with its Competitiveness Project. The project's themes were "market driven, customer focused, cost conscious and results oriented." BPA reorganized around types of customers served rather than geographical areas. The reorganization created account executives and constituent account executives, providing customers, states and interest groups with more direct links to BPA. (Tribal account executives were added in 2002.)

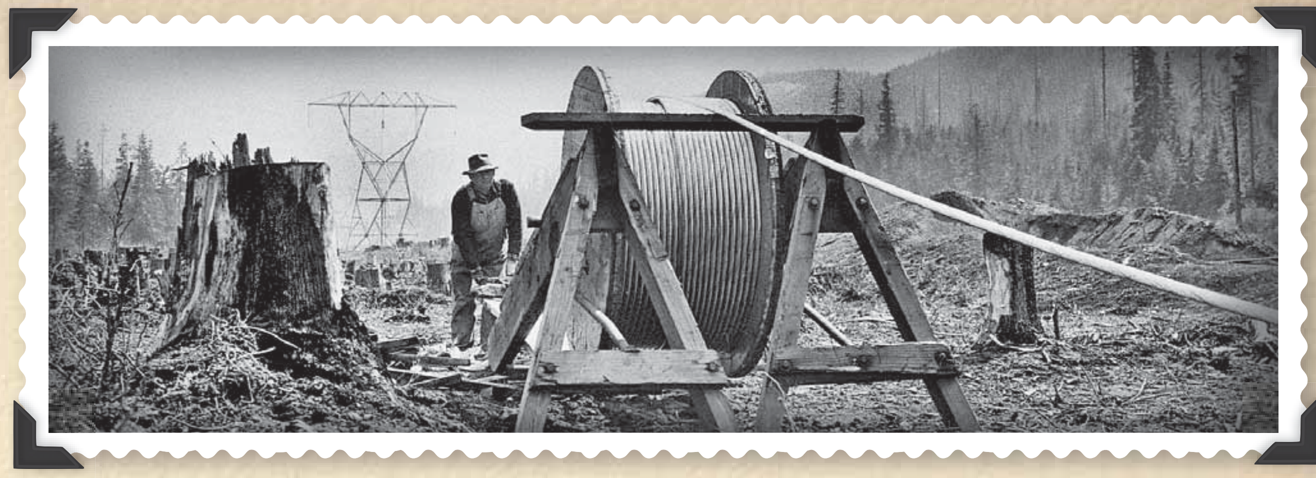
nature of renewable energy. The eight projects focus on wind, ocean wave and in-stream tidal technologies. Funding comes from BPA sales of certified-green Environmentally Preferred Power and Renewable Energy Certificates to utilities and power marketers.

Environment

Climate change objective added

During the year, BPA adopted a new strategic business objective for fiscal years 2008-2014. It addresses mitigation for greenhouse gas emissions. The agency is in the initial stages of preparing a Climate Change Action Plan. As part of our new objective, we will engage with the region to support greenhouse gas mitigation and will integrate mitigation considerations into all relevant internal decisions and processes to ensure internal compatibility. We will include greenhouse gas emission implications as an important criterion in evaluating and selecting strategies and actions for meeting our other environmental/fish and wildlife objectives and power resource acquisitions. Additionally, the agency will track and report its greenhouse gas emissions.

We also are participating in a new Electric Power Research Institute initiative to address climate change by improving power system efficiency and reducing greenhouse gas emissions. EPRI is accelerating research and augmenting deployment of advanced energy efficiency end-use devices, power control systems and peak load management tools. This national effort will leverage contributions from numerous individual utilities.



In 1942, crews strung the Grand Coulee-Covington line from eastern Washington to Puget Sound.

Closer to home, BPA is now in compliance with Executive Order No. 13149, signed in April 2000, which directed federal agencies to reduce petroleum consumption by 20 percent in their fleets. Approximately 240 of the agency's 933 leased or owned vehicles, 26 percent of the fleet, have been equipped to use alternative fuel. Our fleet vehicles are equipped for E-85 fuel, which is a biofuel made primarily from corn or other biomass (85 percent ethanol and 15 percent unleaded). Currently, it costs about 30 cents less per gallon than regular unleaded gasoline. The Ross Complex's fueling station began offering E-85 in September 2006.

Fish and wildlife

BPA funded numerous projects

In fiscal year 2007, BPA agreed to fund 260 projects recommended for funding by the Northwest Power and Conservation Council. Half of these funding decisions have out-year implications through fiscal year 2009. In making these decisions, we strove to remain within our $143 million annual fish and wildlife program expense budget, while at the same time substantially deferring to the Council's recommendations. We also have tried to shift more of our funding to on-the-ground activities that provide direct and immediate benefits to fish and wildlife, while not increasing but more finely tuning monitoring, evaluation and research efforts directly related to Federal Columbia River Power System management questions.

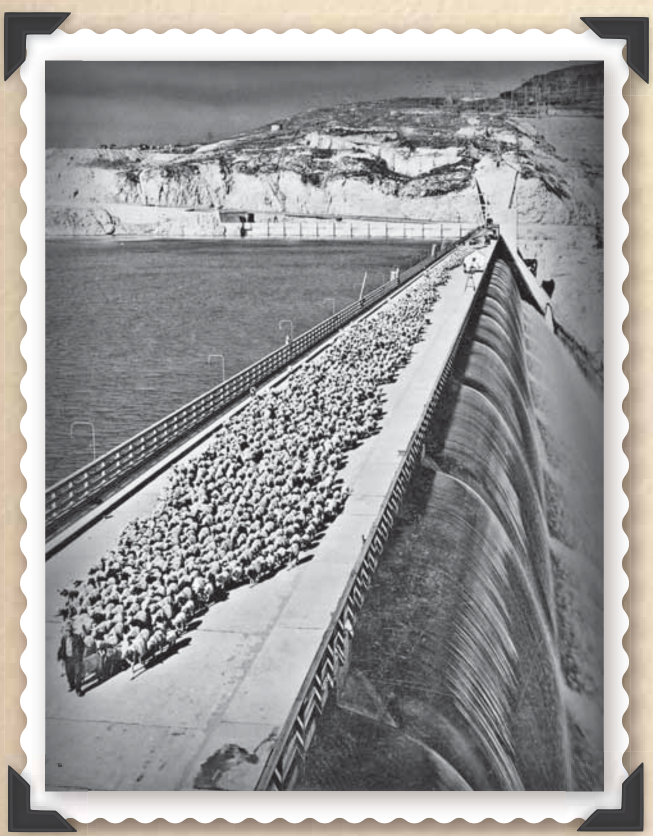
We also funded 41 additional projects. Nearly all of these fish and wildlife projects reflected commitments in the 2007 hydro system operations agreement with five Northwest tribes for additional habitat restoration work for species listed under the Endangered Species Act in high-priority subbasins.

Fish protection measures tested

During the year, BPA conducted a number of procedures in conjunction with other federal agencies to protect or test protection of Columbia Basin fish. Examples of these procedures included maintaining tailwater elevations below Bonneville Dam at higher levels to protect chum eggs; releasing very cold water from the depths of Dworshak Dam in Idaho to maintain colder — and thus healthier — temperatures for salmon in the

Clearwater River; pulsing flows at Montana's Libby Dam to facilitate spawning and incubation of endangered Kootenai River white sturgeon; and supporting the planting of 8,000 trees to improve riparian habitat along Idaho's Lapwai Creek.

We also took public comments on an environmental impact statement for a proposed program to assist in conservation and recovery of summer/fall chinook salmon in the Okanogan subbasin and in the Columbia River below Chief Joseph Dam. This program would include a new fish hatchery near the base of Chief Joseph Dam and acclimation ponds throughout the Okanogan River subbasin. The program includes production to augment the ceremonial and subsistence harvest of salmon for the Confederated Tribes of the Colville Reservation.



Grand Coulee also carried cars (and sheep) across the Columbia River.

New wildlife habitat added

During the year, BPA either acquired or began the process to acquire land and conservation easements for wildlife habitat in Oregon's Willamette Valley, in the St. Joe, Pack and Priest river watersheds in Idaho, and along Washington's Calispell Creek watershed. All together, these acquisitions will protect approximately 5,500 acres of wildlife habitat. Endangered or threatened plants also will benefit from the protection.

Hydro operations included tribal agreement

This year's Federal Columbia River Power System operations for juvenile salmon and steelhead were similar to what the U.S. District Court ordered in 2006. This included spilling water at Lower Snake and Columbia River dams from April through the end of August, in addition to providing augmented streamflows. While streamflows were much lower in 2007, NOAA Fisheries scientists estimated that juvenile spring chinook survival through the hydro system was similar to 2006, when streamflows were well above average. Adult survival in 2007 also continued to reflect recent improvements.

The operations also reflected an agreement this year with the federal action agencies (BPA, the U.S. Army Corps of Engineers and Bureau of Reclamation) and five Northwest Indian tribes. It provided bridge funding through September 2007 for specific fish and wildlife projects in addition to those recommended by the Council. In September, these agreements were extended for six months. This is the first hydro operation agreement reached with the tribes in litigation challenging the 2004 Biological Opinion.

BPA collaborated in work for biological opinion

In August, BPA, the U.S. Army Corps of Engineers and Bureau of Reclamation sent biological assessments to the National Oceanic and Atmospheric Administration National Marine Fisheries Service (NOAA Fisheries). The assessments evaluate potential impacts of the agencies' proposed actions on fish listed under the Endangered Species Act. A comprehensive biological analysis accompanied the biological assessments. This analysis looked at each individual fish population, among the listed species, to identify its status and the barriers to recovery. Proposed actions were then tailored to meet each specific population's needs.

In May, the federal agencies had sent NOAA Fisheries their "proposed action" describing how the hydro system would be operated to avoid jeopardy to listed fish and their habitat. NOAA then used these documents as a basis for a new draft biological opinion, issued at the end of October 2007.

This effort, which involved extensive collaboration with states and tribes, responded to a directive from U.S. District Court Judge James Redden. In October 2005, responding to lawsuits brought by environmentalists and fishing interests, Judge Redden found the 2004 FCRPS Biological Opinion invalid. He remanded the Biological Opinion

2000s

The decade opened with a West Coast energy crisis that sent electric power market prices soaring and BPA revenues dipping. BPA applied stringent cost management and efficiency initiatives and was again operating in the black by fiscal year 2003, despite consecutive low-water years. After losing more than $700 million during the energy crisis, BPA had largely made it back from those losses by 2006. The final chapter of the decade remains to be written as BPA balances multiple issues including equitable and lawful distribution of federal power benefits, fish and wildlife mitigation, transmission reliability and the need to determine BPA's role in mitigating climate change.

back to NOAA Fisheries and directed the federal action agencies to work with Columbia Basin tribes and the four Northwest states to develop a new plan.

The new plan reflects a 10-year program of major new funding commitments beyond what were proposed in the 2000 and 2004 biological opinions. The proposed action covers improvements at dams and in hydro operations; habitat enhancements throughout the Columbia and Snake tributary rivers and in the estuary; hatchery reforms and use of conservation hatcheries; and control of avian, fish and marine mammal predators. It represents a science-based approach to recovery with performance standards, targeted actions that address those populations most in need, and related research and reporting.

Internal operations

Efficiency initiatives continued

A new BPA organizational model took effect Oct. 1, 2006. The new model strengthens agency policy and planning and consolidates shared functions to help BPA improve delivery of its mission. We also have been revising our policy-making procedures and governance to ensure we fulfill our core agency values, which include:

- Trustworthy stewardship,
- Collaborative relationships, and
- Operational excellence.

The Enterprise Process Improvement Program, begun in 2004, continued as BPA dedicated itself to an ongoing effort to ensure the most efficient delivery of our services. We are now saving tens of millions of dollars a year due to process improvements realized as a result of this multi-year effort. Savings are accruing in a number of ways, ranging from cost reductions to doing more without added costs.

Finally, on Aug. 20, BPA celebrated its 70th anniversary. Our agency's history, from the electrification of the rural Northwest to today's efforts to ensure that the value of the Columbia Basin's great resources are preserved for the region, is an integral part of the Pacific Northwest's legacy. Highlights of BPA's seven decades of service to the Northwest can be found throughout this report.

Each year since 1996, BPA has selected a set of key agency targets that the organization as a whole is responsible for achieving. These act as indicators of overall agency performance and are used in evaluating agency management. BPA met 25 of its 28 key agency targets in fiscal year 2007.

Stakeholder Perspective

Transmission system

Target met. BPA met its transmission capital work plan management target by on-time completion of 32 of the 33 highest priority projects and 51 of the 59 second highest priority projects, by five of six targeted capital programs within budget, and by nine of 10 major targeted capital projects put in service on schedule and within budget.

Commercial transmission decision framework

Target met. BPA completed, on schedule, the development and testing of an evaluation and decision-making framework for construction of new primarily commercial transmission facilities. Development included establishing a regional work group. The "West of McNary Generation Integration Project" was used to test the framework.

Transmission adequacy

Target met. Regional transmission adequacy guidelines on Remedial Action Schemes and Load/Transfers were voted upon and approved by the Northwest Power Pool Regional Transmission Adequacy Steering Committee by March 31, 2007. They include metrics and targets that will provide more definition and measurability of recommended levels of service.

Hydro generation system

Target not met. Generation was increased by 2.25 average megawatts by Sept. 30, 2007, and was within budget through the hydro efficiencies program's installation of a new turbine runner replacement at Grand Coulee Dam. However, completion of the second 2.25-average megawatt runner replacement was delayed with the discovery of asbestos abatement needs during the year (December 2007 completion is expected).

Energy efficiency/demand management

Target met. BPA achieved 52 average megawatts of new conservation savings versus a target of 47 to 57 average megawatts, and did so at a cost of under $1.4 million per average megawatt versus a target of under $1.5 million.

Resource adequacy

Target met. BPA created a plan to implement the regional Energy Adequacy and Pilot Capacity Adequacy Standards on a test basis and used the results of the test to advocate for refinement of the standards. BPA was successful in getting the PNW Resource Adequacy Forum to consider a BPA-proposed standard approach that dealt more realistically with hydro operations than the pilot standard. The proposal is being considered within the regional process at this time, with the Forum deciding to delay establishment of a revised Capacity Adequacy Standard until the first quarter of FY 2008.

Transmission reliability

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

Transmission availability

Target met. BPA's most important transmission lines were available for service 99.1 percent of the time, exceeding the target of 98.0 percent and providing the lowest total duration of planned outages in the past five years.

Generation reliability

Target met. There were no involuntary curtailments of firm load due to inadequate power supply or 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 achieved 99.6 percent heavy-load-hour availability, exceeding the target of 97.5 percent.

Regional Dialogue implementation

Target not met. The Regional Dialogue Policy and record of decision were not released until July 18, 2007, which delayed the onset of regional discussions regarding implementation. Since then, a number of Regional Dialogue Implementation Workshops have been held throughout the year to discuss the tiered rates methodology, power services products and rate design with customers and other stakeholders.

Regional transmission coordination

Target not met. BPA collaborated with ColumbiaGrid to implement the Planning and Expansion Functional Agreement, and ColumbiaGrid executed a Reliability Functional Agreement. However, ColumbiaGrid gained only one new participant versus a target of three, and no new members against a target of two.

Congestion management implementation

Target met. BPA put adequate systems, information and procedures in place by July 1 to manage congestion, including limiting nonfirm transactions and hourly firm transactions on constrained transmission paths, and conducting a successful reliability redispatch pilot on four flowgates in the third quarter against a target of the fourth quarter.

Wind Integration

Target met. The Wind Integration Action Plan was completed on March 15 with strong regional buy-in, against a target of April 1. Analysis of integrating 5,000 MW of wind into the Federal Columbia River Power System in collaboration with regional participants was also completed on time.

Transmission rates

Target met. The administrator signed the FY 2008-2009 Transmission Rates record of decision resulting in no annual average increase from the previous rate. The rate was filed with the Federal Energy Regulatory Commission on May 22, 2007.

ESA compliance

Target met. Based on regional collaboration with sovereign (state/tribal/federal) parties to the FCRPS Biological Opinion court-ordered remand, BPA, the Corps of Engineers and the Bureau of Reclamation jointly developed a revised action for operation and maintenance of the FCRPS and an extensive biological analysis. The revised action contains a framework for funding certainty/predictability of the actions and performance standards to measure progress. NOAA Fisheries issued a draft biological opinion on the revised action on Oct. 31, 2007, and will finalize the biological opinion according to a schedule to be set by the Federal District Court.

Customer satisfaction

Target met. Survey results showed a customer satisfaction rating of 7.7, exceeding the target of 7.0 to 7.5 out of a possible 10.

Constituent satisfaction

Target met. Survey results showed a constituent satisfaction rating of 7.6, exceeding the target of 7.0 to 7.5.

Tribal government satisfaction

Target met. Survey results showed a tribal government satisfaction rating of 6.9, exceeding the target of 6.0 to 6.5.

Financial Perspective

Modified net revenues

Target met. BPA's modified net revenues for FY 2007 were $217.3 million, substantially exceeding the target range of $50 million to $150 million. The primary reasons for this were higher-than-projected Transmission revenues and lower expenses for both Power and Transmission.

Treasury payment

Target met. BPA's FY 2007 payments to the U.S. Treasury of $1.045 billion were made on time and in full for the 24th consecutive year.

Debt optimization

Target met. BPA achieved this target with completion of the Energy Northwest/BPA bond sale for debt optimization refinancing of $232 million in the third quarter and the prepayment of $289 million for early federal debt amortization on Sept. 30, 2007.

Bond rating

Target met. BPA maintained ratings of "AA-" or better from all three rating agencies for BPA-backed bonds during FY 2007 (S&P AA-; Fitch AA-; Moody's Aaa), and Fitch has upgraded the rating from "stable" to "positive" outlook.

Internal Operations Perspective

Internal operating costs

Target met. Overall expenditures (including capital and expense) were $501.8 million, representing 97 percent of the start-of-year budget.

Process improvement

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

People and Culture Perspective

Workforce gap closure

Target met. BPA implemented 94 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

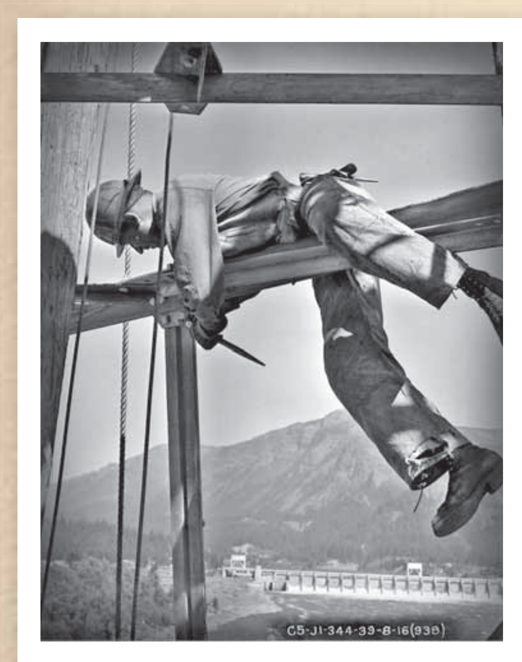
Target met. Based on an annual employee survey, 76 percent of employees confirmed that they understand BPA's business strategy, well within the target range of 70 to 80 percent.

Safety

Target met. BPA achieved a lost-time accident frequency rate of 1.3 per 200,000 hours worked, well within the target range of 1.1 to 1.5 (lower is better) and 46 percent lower than the utility industry average of 2.4. There were no fatal injuries to BPA employees or contract employees working on BPA facilities.

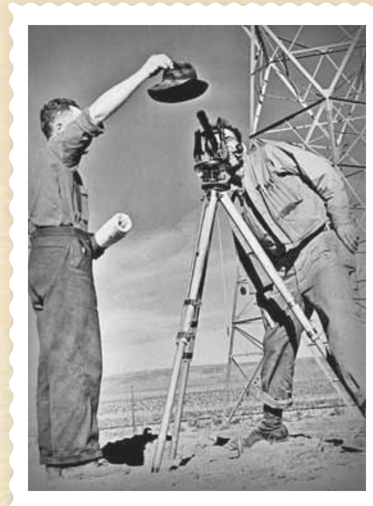
Bonneville Power Administration

Serving the Pacific Northwest since 1937

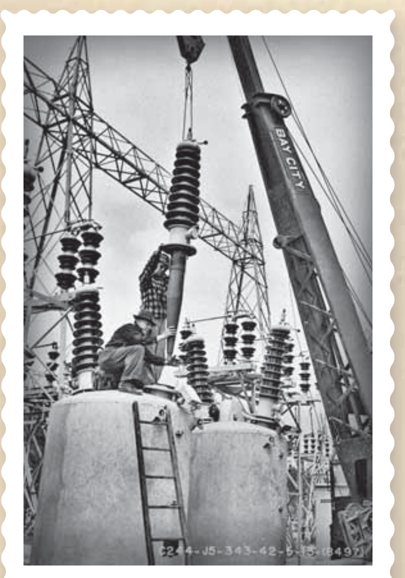


Bolting together transmission towers below Bonneville Dam ...

... and on the Pacific Northwest-Pacific Southwest Intertie.

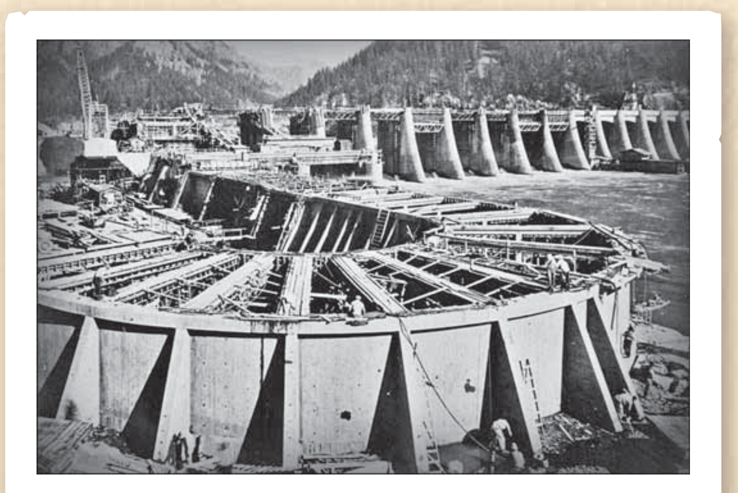


Surveying the first Bonneville-Grand Coulee line.



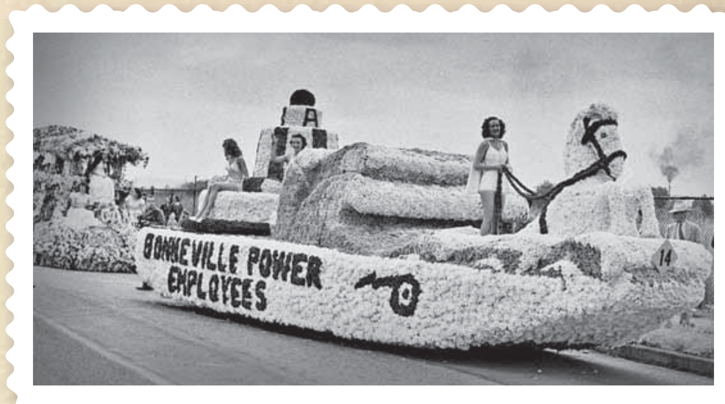
Building Longview Substation in Washington.

U.S. Army Corps of Engineers

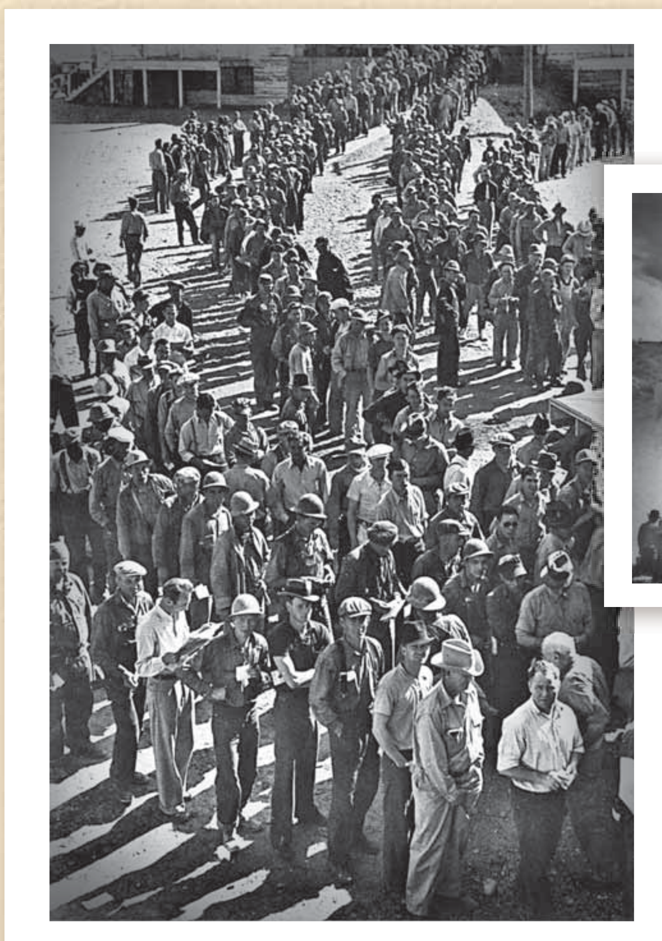


Funding fish ladders at Bonneville Dam.

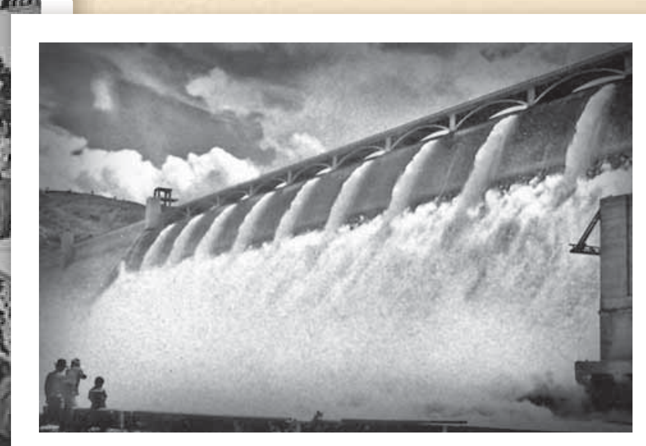
Clearing rights-of-way.



Participating in the community.



Oregon Historical Society



Bringing jobs during the Great Depression and providing clean, renewable hydropower for 70 years.

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 nonfederal power plants. BPA also operates and maintains about three-fourths of the region's high-voltage transmission. More than 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 is committed to providing public service and seeks to make its decisions in a manner that provides opportunities for input from all stakeholders.

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

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

FINANCIAL SECTION

General

The Federal Columbia River Power System combines the accounts of the Bonneville Power Administration, the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers and the Bureau of Reclamation, as well as the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan Facilities. In addition, Northwest Infrastructure Financing Corporations are "Special Purpose Corporations" that are consolidated with BPA.

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

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

BPA's primary customer service area is the Pacific Northwest region of the United States, encompassing the states of Idaho, Oregon, Washington, western Montana, and small parts of eastern Montana, western Wyoming, northern Nevada, Utah and northern California. The population of the 300,000 square mile service area is approximately 12 million people. Electric power sold by BPA accounts for about one-third of the electric power consumed within the region. BPA markets the majority of this power to over 100 publicly owned and cooperatively owned utilities for resale to consumers in the region. BPA also had contracts to sell power for direct consumption to a small number of companies (direct-service industries or DSIs) located in the region through fiscal year 2006. With current power rates effective October 2006, BPA began providing monetary payments to help the DSIs purchase power from their local electric providers.

BPA is required by law to exchange power with qualifying utilities to meet their residential and small-farm electric power loads within the region. The operation of this program, referred to as the Residential Exchange Program, may result in payments by BPA to the exchanging utilities if the applicable power rates for FCRPS power are lower than the utilities' respective average system cost of meeting their residential and small-farm power loads. The primary participants in the Residential Exchange Program historically have been investor-owned utilities in the region.

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

Although BPA is a non-jurisdictional utility, it voluntarily provides open access, non-discriminatory transmission service to all requestors under tariffs approved by the Federal Energy Regulatory Commission. In addition, BPA conforms to FERC standards of conduct to ensure its transmission function does not discriminatorily advantage its merchant power function.

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

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

Power Rates Adjustment Tools

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

The LB CRAC was a percentage rate adjustment and was based on BPA's costs to purchase power to meet load obligations. Because BPA acquires some portions of this power in a highly volatile market, it was not possible to forecast accurately the cost of purchasing this power over the entire five-year rate period. Accordingly, the LB CRAC was designed to respond to changes in the market price of power and to reflect the change in prices in the power purchase contracts. It was reset every six months to recover the anticipated augmentation costs to meet load that could not be recovered with the base rates, followed by true-ups to the actual costs. The FB CRAC triggered if the forecast of accumulated modified net revenues for power fell below a threshold value for a particular year, and allowed a temporary, one-year adjustment to the base rates in addition to the LB CRAC. Both the LB and FB CRACs were in effect during fiscal years 2005 and 2006. The SN CRAC was designed to raise rates if a payment to the U.S. Treasury or other creditor was missed, or if the administrator projected a 50 percent or higher probability that such a payment might be missed in the then-current fiscal year. The SN CRAC was not triggered for fiscal year 2005; however in late 2005 it was triggered and became effective during fiscal year 2006.

Under BPA's approved interim rates effective Oct. 1, 2006, these CRACs were replaced with a single CRAC that can raise additional revenues up to $300 million when the forecast of accumulated power net revenues fall below a threshold value for a particular year. The National Marine Fishery Service Federal Columbia River Power System, Biological Opinion Rate Adjustment Mechanism increases the CRAC ceiling for qualifying costs and the addition of the Emergency NFB Surcharge allows an immediate within-year adjustment for qualifying costs. The Dividend Distribution Clause established for the 2002-2006 power rate period is continued. The DDC allows BPA to distribute rebates to customers if accumulated net revenues at the end of the prior year exceed a pre-set threshold. Subject to final approval from FERC, these rates will continue to be in effect from Oct. 1, 2006, through Sept. 30, 2009.

Sources of Operating Revenues

BPA sells power (energy and capacity) and related services to four main types of customers: Northwest publicly owned utilities, Northwest investor-owned utilities, other regional and extra-regional customers. BPA also sells relatively small amounts of power to several federal agencies within the region. BPA sells transmission and related services under open-access tariffs to a broad variety of power generators, including wind generators, marketers and power purchasers.

Sales Within the Northwest Region

Northwest Publicly Owned Utilities

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

Direct-Service Industries

BPA is not required to do so, but may offer to sell power for direct consumption to a limited number of existing DSIs within the region. Beginning with the current rate period that began Oct. 1, 2006, BPA no longer delivers power to the DSIs but instead provides the DSIs monetary benefits to be used for their power purchases.

Northwest Investor-Owned Utilities

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

Sources of Operating Revenues

Federal Columbia River Power System

For the fiscal years ended Sept. 30 — thousands of dollars

	2007	2006	2005
Sales of electric power:			
Sales within the Northwest region			
Northwest publicly owned utilities	**$ 1,836,731**	$ 1,711,889	$ 1,717,063
Direct-service industries	**—**	80,021	82,454
Northwest investor-owned utilities	**281,362**	502,601	390,511
Sales outside the Northwest region	**460,656**	691,508	600,765
Bookouts	**(94,705)**	(220,911)	(238,847)
Total sales of electric power	**2,484,044**	2,765,108	2,551,946
Transmission	**689,287**	641,132	527,383
Other revenues	**29,212**	(63,224)	131,054
U.S. Treasury credits for fish	**66,097**	76,353	57,700
Total operating revenues	**$ 3,268,640**	$ 3,419,369	$ 3,268,083

May 2007, the United States Court of Appeals for the Ninth Circuit ruled these agreements invalid (See Notes 8 and 9, Other Liabilities and Commitments and Contingencies, respectively).

The Residential Exchange Program continues to be a requirement of the Northwest Electric Power Planning and Conservation Act. Efforts are under way to develop a within-region solution to restoring appropriate benefits under the program. BPA expects any proposed solution to require initiation of a formal rate-setting process. Until the uncertainty about the level of the future BPA obligations under the Residential Exchange Program is reduced, BPA financial statements will continue to reflect the obligations at levels associated with the settlement agreements.

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

Sales Outside the Northwest Region

BPA sells some secondary energy to various extra-regional buyers and marketers when it is in excess of what is needed to serve firm load obligations in the region. Revenue from these sales fluctuates with streamflows in the Columbia River Basin. Streamflows directly affect the amount of secondary energy available for sale, which, along with the costs of generating power with alternative fuels, ultimately affects the price BPA can obtain for its secondary sales.

Bookouts

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.

Transmission

Transmission revenues are primarily earned from long-term take-or-pay contracts but can fluctuate based upon a number of factors, including the amount of unused transmission line capacity available to sell, as well as weather and hydro conditions. BPA's Transmission Services is required to provide transmission service to electric utilities, generators and marketers under the same open-access tariffs it uses to serve BPA's Power Services.

Other Revenues

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

U.S. Treasury Credits for Fish

The Northwest Power Act obligates BPA to make expenditures on a reimbursement basis for protection, mitigation, and enhancement for fish and wildlife affected by the development and operation of the FCRPS for both power and nonpower purposes. The Northwest Power Act 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 ensures that the costs of mitigating these impacts are properly accounted for among the various purposes of the hydroelectric projects. In the early 1990s, BPA, the U.S. Treasury and the Office of Management and Budget agreed to a crediting mechanism whereby BPA reduces its payments to the U.S. Treasury by an amount equal to the mitigation measures funded on behalf of the nonpower purposes.

Liquidity and Capital Resources

Operating Activities

Cash provided by operating activities decreased $441 million to $872 million for the fiscal year ended Sept. 30, 2007, compared to $1.313 billion for the fiscal year ended Sept. 30, 2006. The decrease was primarily due to BPA and Energy Northwest entering into a new financial arrangement in fiscal year 2006 called direct-pay. Energy Northwest's cash flow needs are funded by BPA each month 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.

Cash provided by operating activities of the FCRPS increased $636 million to $1.313 billion for the fiscal year ended Sept. 30, 2006, compared to $677 million for the fiscal year ended Sept. 30, 2005. Better than average precipitation, streamflows and strong market prices contributed to higher net revenues in fiscal year 2006. As previously discussed BPA and Energy Northwest entered into a new financial arrangement called direct-pay in fiscal year 2006.

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

The change in operating cash flow primarily reflects the changes in net revenues and differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities.

Investment Activities

Cash used for investment activities of the FCRPS increased $21 million 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. The National Telecommunications and Information Administration Organization Act provided for reallocation from federal use to nonfederal use of specific telecommunications frequencies. BPA had invested in telecommunications equipment using frequencies specified in the act during the course of constructing and operating the FCRPS generation and transmission facilities. The Commercial Spectrum Enhancement Act created the SRF to provide a centralized and streamlined funding mechanism through which federal agencies are permitted to offset costs associated with relocating their radio communications systems from displaced spectrum bands. During the second quarter of fiscal year 2007, BPA received approximately $49 million for this purpose. These funds are expected 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. Another significant change between the fiscal years was the deposit to special purpose corporation's trust funds of $51 million of proceeds from the Master Lease Program, which is discussed later, for Northwest Infrastructure Financing Corporation II.

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

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

Financing Activities

Cash used for financing activities of the FCRPS was $153 million for the fiscal year ended Sept. 30, 2007, compared to $292 million for the fiscal year ended Sept. 30, 2006.

The reduction was the result of a $54 million decrease in repayment of bonds issued to the U.S. Treasury, federal construction appropriations decreasing $32 million, a $14 million decline in nonfederal debt relative to the prior year and $39 million customer's advances for construction.

Net nonfederal debt increased for two reasons. In June 2007, BPA signed a master lease agreement with the Northwest Infrastructure Financing Corporation II for third-party financing of transmission capital investments. Under the master lease, 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 used for financing activities of the FCRPS was $292 million for the fiscal year ended Sept. 30, 2006, compared to $186 million for the fiscal year ended Sept. 30, 2005. The $106 million increase was primarily the result of a decrease in bonds outstanding issued to the U.S. Treasury.

Cash used for financing activities of the FCRPS was $186 million for the fiscal year ended Sept. 30, 2005, compared to $132 million provided by financing activities for the fiscal year ended Sept. 30, 2004. In fiscal year 2004, Northwest Infrastructure Financing Corporation issued $119.6 million in taxable bonds to finance the Schultz-Wautoma transmission line.

Cash Balances and BPA Reserves

At Sept. 30, 2007, the FCRPS ending cash balance on the Combined Balance Sheet was $1.476 billion. The Corps and Reclamation combined cash balances were $148 million.

BPA's fiscal year-end cash was $1.328 billion and deferred borrowing authority was $135 million, the sum of which equals BPA's reserves of $1.463 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 2006 and 2005, BPA's fiscal year-end cash and deferred borrowing authority were $1.105 billion and $88 million, and $548 million and $6 million, respectively.

BPA Statutory Borrowing Authority

The aggregate principal amount of bonds BPA is authorized to sell to the U.S. Treasury and to have outstanding at any one time is $4.45 billion. Of the $4.45 billion in borrowing authority that BPA has with the U.S. Treasury, $2.24 billion of bonds were outstanding as of Sept. 30, 2007. 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 Electric Power Planning and Conservation Act.

The interest on BPA's outstanding bonds issued to the U.S. Treasury is set at rates comparable to the rates prevailing in the market for similar bonds issued by government corporations. As of Sept. 30, 2007, the interest rates on the outstanding bonds ranged from 2.95 percent to 8.55 percent with a weighted average interest rate of approximately 5.4 percent. The terms of the outstanding bonds vary from three to 34 years. The term of the bonds is limited by the average expected service life of the associated investment or 50 years, whichever is less. The average expected service life is 40 years for transmission facilities, 75 years for Corps and Reclamation capital investments, up to 20 years for conservation investments, and 15 years for fish and wildlife projects. Bonds can be issued with call options. At Sept. 30, 2007, BPA had eight callable bonds on its books totaling $389 million.

Master Lease Program

BPA has entered into separate arrangements with two special purpose corporations, Northwest Infrastructure Financing Corporation and Northwest Infrastructure Financing Corporation II. The arrangement with NIFC II constitutes the framework for the Master Lease Program. The Master Lease 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 and several lease purchase commitments with NIFC II for individual transmission assets having an estimated cost to construct of about $51 million in aggregate. The construction costs of the assets are being financed through a bank line of credit between NIFC II and Citibank. Payment of the debt service on the line of credit is secured solely by BPA's lease payments to NIFC II with respect to the related transmission assets. NIFC II 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 assets will be completed in fiscal 2008, although a few of the assets have multiple year construction periods. Under the agreements, NIFC II has leased the assets to BPA until fiscal year 2014, 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, the proceeds of which will be used to pay off the bank line of credit.

Treasury Payment

BPA paid the U.S. Treasury $1.045 billion for fiscal year 2007, making it the 24th consecutive year in which BPA has made its payments on time and in full. The fiscal year 2007 payments included $618.4 million in principal and $394.6 million in interest for bonds issued to the U.S. Treasury and for the appropriated federal investment in the FCRPS. This fiscal year's principal payment included $288.9 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 $32.4 million in other obligations, including $21.1 million of additional funding for post-retirement benefit programs provided to employees associated with the oper-ation of the FCRPS. Payments made in fiscal years 2006 and 2005 were $1.113 billion and $1.088 billion, including $337.1 million and $313 million, respectively, to repay federal appropriations and bonds issued to the U.S. Treasury in excess of those scheduled in FERC filings.

Credit Ratings

BPA maintained high credit ratings on nonfederal debt backed by BPA with the three bond rating agencies covering BPA. In fiscal year 2007, Moody's maintained its credit rating on BPA-backed third party bonds at Aaa, and Standard & Poor's and Fitch maintained their ratings on BPA-backed third party bonds at AA minus. Fitch also raised the rating outlook to positive from stable during fiscal year 2007.

Contractual Obligations and Federal Payments

Amounts shown in the table below for federal appropriations, bonds issued to U.S. Treasury and nonfederal debt include interest and therefore are greater than amounts reflected in the Combined Balance Sheets and described in the accompanying Notes to Financial Statements, Notes 5 through 7. Asset retirement obligations also include interest and are described in Note 2. Estimated amounts for IOU exchange benefits and DSI benefits after 2011 are not presently known. These are described in Note 8. 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. Irrigation assistance is treated as a distribution from accumulated net revenues when paid. These are described in Note 9.

Total contractual obligations decrease approximately $630 million between fiscal year 2009 and fiscal year 2011 primarily due to the changes in amounts for bonds issued to U.S. Treasury, and estimated IOU exchange and DSI benefits. Bonds issued to U.S. Treasury are listed by maturity date. Because IOU exchange benefits for 2010 and 2011 cannot be reasonably estimated under Statement of Financial Accounting Standards 5, "Accounting for Contingencies," until the 2010-2011 rate case process ends, the floor of $100 million per fiscal year has been recorded for 2010 and 2011 versus the cap of $300 million per fiscal year for the 2007-2009 rate period. In accordance with the contract, the benefits for 2010 and 2011 will be calculated when the Forward Flat-Block Price Forecast is available. Certain risk contingency payments and deferred payment obligations of $100 million are included at $25 million for 2008 through 2011.

Contractual Obligations and Federal Payments

As of Sept. 30 — thousands of dollars

	2008	2009	2010	2011	2012	2013+	Total
Federal appropriations	$ 272,493	$ 270,703	$ 263,900	$ 281,080	$ 282,956	$ 10,352,268	$ 11,723,400
Bonds issued to U.S. Treasury	595,375	532,701	432,707	189,615	87,300	1,478,230	3,315,928
Nonfederal debt	644,574	627,770	614,902	588,326	733,583	6,063,835	9,272,990
Asset retirement obligations	8,608	9,352	10,195	11,147	12,253	332,064	383,619
IOU exchange benefits	325,000	325,000	125,000	125,000	—	—	900,000
DSI benefits	54,306	54,158	59,000	59,000	—	—	226,464
Purchase power commitments	53,696	48,391	23,024	24,439	—	—	149,550
Additional post-retirement contributions	18,000	30,554	—	—	—	—	48,554
Irrigation assistance	2,950	7,279	—	—	1,201	677,793	689,223
Total contractual obligations	$1,975,002	$ 1,905,908	$1,528,728	$1,278,607	$1,117,293	$ 18,904,190	$ 26,709,728

Results of Operations

Fiscal Year 2007 Compared to Fiscal Year 2006

As reported in the Combined Statement of Revenues and Expenses that follows, for the fiscal year ended Sept. 30, 2007, FCRPS total operating revenues were $3.269 billion, a decrease of $151 million from the prior fiscal year. Revenues from electricity and transmission sales for the fiscal year ended Sept. 30, 2007, were down $234 million, or 7 percent from last fiscal year.

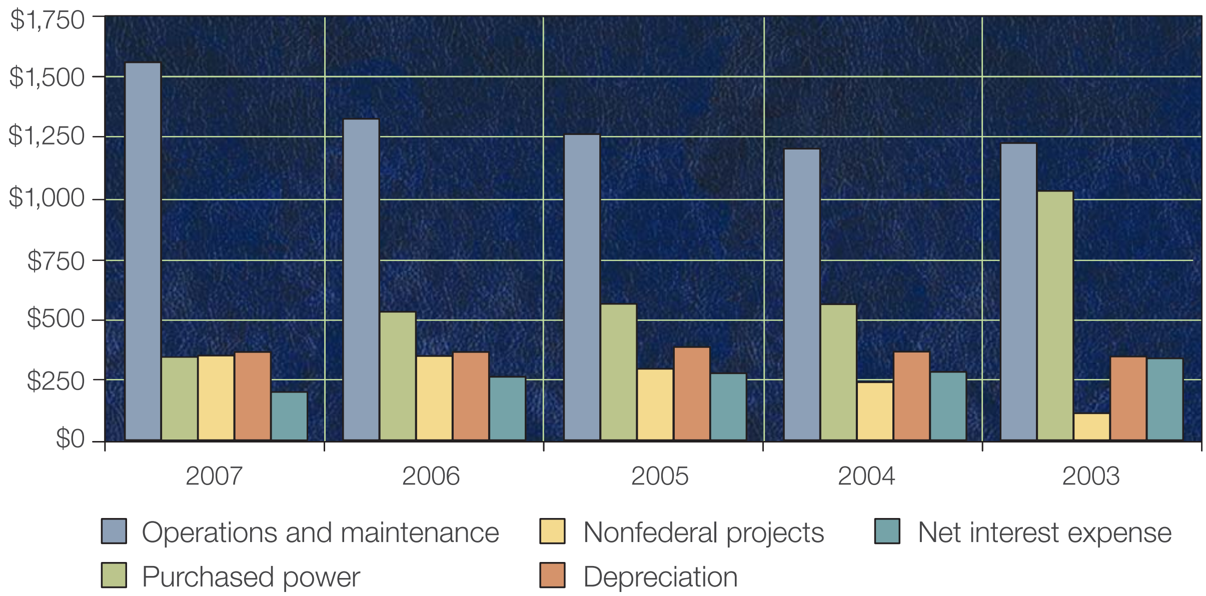
Power revenues decreased $281 million, or 10 percent from last fiscal year. Reduced streamflows, the bi-annual refueling of Columbia Generating Station nuclear power plant and reduced power purchases drove down generation; therefore, less secondary energy was available for sale. Under interim rates during fiscal year 2007, BPA is providing monetary benefits rather than power to the DSIs. Under settlement agreements, BPA is providing monetary benefits rather than power for residential and small-farm customers of the IOUs.

Transmission revenues increased $47 million, or 8 percent from last fiscal year mainly due to increased sales under long-term point-to-point network and short-term intertie contracts. Load based sales also increased due to greater than anticipated load growth. Part of the increase is associated with revenues from Ancillary Services, which vary with the sale of transmission and are needed to ensure efficient and reliable service.

In total, operating expenses 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. The increase was primarily a result of IOU Residential Exchange Benefits

Expenses by category

millions of dollars



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 current rate period beginning on Oct. 1, 2006, the IOU Residential Exchange benefits settlements are entirely monetary payments pursuant to agreements intended to settle the Residential Exchange Program benefits provided by the Northwest Power Act as discussed above in Northwest Investor-Owned Utilities. These current payments are included in operations and maintenance expenses. Although the nature of the payments has changed, the total is approximately the same. Also increasing O&M costs, although to a lesser extent, were increased costs for operating the Columbia Generating Station nuclear power plant. The budget requirements were higher than last 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 the current fiscal year. 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 last fiscal year. Interest expense on appropriated funds increased $9 million. Interest on bonds issued to the 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.

Fiscal Year 2006 Compared to Fiscal Year 2005

For the fiscal year ended Sept. 30, 2006, FCRPS total operating revenues were $3.419 billion, an increase of $151 million from the prior fiscal year. Revenues from electricity and transmission sales for the fiscal year ended Sept. 30, 2006, increased $318 million from one year earlier. Power revenues increased due to higher spot market power sales enabled by increased runoff. Transmission revenues also increased due to the load growth and increased secondary energy sales discussed above and from an Oct. 1, 2005, transmission rate increase of approximately 12.5 percent leading to higher revenues for the current year. Statement of Financial Accounting Standards 133, "Accounting for Derivative Instruments and Hedging Activities," derivative mark-to-market amount for the fiscal year ended Sept. 30, 2006, decreased $195 million when compared to the prior year due to a drop in the forward prices, physical delivery and a change in the overall portfolio mix.

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

Net interest expense for the fiscal year ended Sept. 30, 2006, decreased $16 million, or 6 percent, compared to a year ago. Interest on appropriated funds owed the U. S. Treasury increased $13 million or 7 percent. Interest on bonds issued to the U. S. Treasury decreased $6 million or 4 percent as the weighted average interest rate declined from 4.9 percent at the beginning of fiscal year 2005 to 4.8 percent at the beginning of fiscal year 2006. Allowance for funds used during construction increased $12 million or 69 percent reflecting the Transmission Services construction work on the Schultz-Wautoma transmission line. Interest income increased $11 million with higher cash balances.

Fiscal Year 2005 Compared to Fiscal Year 2004

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

In total, operating expenses increased $95 million, or 4 percent, when compared to the prior year. Operations and maintenance increased $45 million, or 4 percent. This increase reflects the effects of higher operating costs at the Columbia Generating Station nuclear power plant of $21 million, mainly for nuclear fuel, and increased payments of IOU residential exchange benefits of $18 million. Operating expenses also reflect that purchased power decreased $2 million, or less than 1 percent, compared to the fiscal year ended Sept. 30, 2004, and that nonfederal projects debt service expense increased $43 million, or 17 percent. The nonfederal project debt service expense increased in part because the Energy Northwest fiscal year 2004 operating budgets included approximately $79 million that was made available when reserve funds for certain Energy Northwest net-billed bonds

Selected Quarterly Information

Federal Columbia River Power System

3 months ended — thousands of dollars

	Dec. 31	March 31	June 30	Sept. 30	Totals
2007					
Revenues	**$ 819,166**	**$ 868,151**	**$ 841,415**	**$ 746,427**	**$ 3,275,159**
SFAS 133 mark-to-market	**(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
SFAS 133 mark-to-market	(32,969)	(22,888)	(19,833)	(24,403)	(100,093)
Operating revenues	818,496	909,989	855,799	835,085	3,419,369
Operating expenses	615,985	634,345	597,448	698,985	2,546,763
Net interest expenses	70,254	67,016	65,638	58,635	261,543
Net revenues (expenses)	$ 132,257	$ 208,628	$ 192,713	$ 77,465	$ 611,063
2005					
Revenues	$ 776,805	$ 805,778	$ 701,765	$ 889,139	$ 3,173,487
SFAS 133 mark-to-market	(8,826)	15,040	1,914	86,468	94,596
Operating revenues	767,979	820,818	703,679	975,607	3,268,083
Operating expenses	587,015	622,066	642,559	652,289	2,503,929
Net interest expenses	71,491	70,697	67,442	67,654	277,284
Net revenues (expenses)	$ 109,473	$ 128,055	$ (6,322)	$ 255,664	$ 486,870

were replaced with surety agreements. The surety agreements were used to reduce fiscal year 2004 net-billing requirements for non-federal projects' debt service. In addition, federal projects' depreciation increased $9 million, or 3 percent, primarily due to the energization of the Grand Coulee-Bell transmission line.

Net interest expense for the year ended Sept. 30, 2005, decreased $8 million, or 3 percent, compared to the prior year. Interest on appropriated funds decreased due to lower principal owed to the U.S. Treasury. Interest on bonds issued to the U.S. Treasury decreased $9 million from fiscal year 2004 as interest rates declined and also because fiscal year 2004 expense included a $4 million bond call premium. The allowance for funds used during construction decreased with lower construction work-in-progress balances.

Selected Quarterly Information

Due to winter heating loads for Northwest utilities, the quarters ending March 31 normally have the highest revenues. Maintenance on transmission facilities occurs mainly during summer, usually resulting in higher operating expenses for the quarters ending Sept. 30.

Critical Accounting Policies

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 over the periods they are included in rates 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, 2007, and 2006. Amortization of these is reflected in the Combined Statements of Revenues and Expenses.

Market Risk

Risk Management

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

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

Commodity Price Risk and Volumetric Risk

Primarily due to the periodic variation in the available energy from its hydroelectric generation capacity, BPA enters into short-term and forward sales and purchase agreements for electricity in the wholesale markets to balance its energy supply and demand. Fluctuations in the electric market prices in the Pacific Northwest can affect the value of energy inventory being bought and sold as well as the value of prior purchase and sale contracts. This is referred to as commodity price risk. In fiscal year 2007, there was a net surplus and sale of energy, which was in excess of that needed to serve firm load obligations in the region.

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

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

Credit Risk

Credit risk relates to the risk of loss that might occur as a result of non-performance by counterparties of their obligations to make or take delivery of electricity. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. During fiscal year 2007, 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. To further manage credit risk, BPA obtains credit support such as letters of credit and third-party guarantees from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly.

At Sept. 30, 2007, BPA had $61 million in credit exposure to purchase and sale contracts taking into account netting rights. BPA uses internally developed, commercially appropriate rating methodologies, credit scoring models, publicly available information and external ratings from major credit rating agencies to determine the public rating equivalent grade of counterparties. At Sept. 30, 2007, BPA's credit exposure, net of collateral, to sub-investment grade counterparties was less than 1 percent of total outstanding credit exposures. The agency's top five credit exposures were $57 million, or 93 percent, of the total credit exposure. The majority of this exposure is mark-to-market exposure arising from a term transaction with an "A+" rated municipality with ratemaking authority.

Interest Rate Risk

BPA does not issue variable rate debt to the U.S. Treasury and is not exposed to substantive risk resulting from changes in interest rates as a result of its backing of the variable rate debt issued by Energy Northwest. Of the $743 million of Energy Northwest variable rate debt outstanding at Sept. 30, 2007, $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, the amount BPA receives is intended to offset the variable rate paid on the $500 million in bonds issued by Energy Northwest. The remaining variable rate debt of approximately $243 million is partially matched against variable rate assets.

Non-GAAP Financial Information

Modified net revenues

Modified net revenues are net revenues after removing the effects of SFAS 133 derivative mark-to-market and nonfederal debt management actions that differ from rate case assumptions. Management has determined that modified net revenues are a better representation of the outcomes of normal operations during periods of debt management actions and fluctuations in derivative market prices.

Modified Net Revenues

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

	2007	2006	2005
Net Revenues	**$ 457,208**	$ 611,063	$486,870
SFAS 133 derivative mark-to-market loss (gain)	**6,519**	100,093	(94,596)
Nonfederal debt management actions	**(246,421)**	(266,249)	(266,139)
Modified net revenues	**$ 217,306**	$ 444,907	$126,135

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, 2007, approximately $2.3 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 aren't 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 debt of $289 million, $337 million and $313 million in fiscal years 2007, 2006 and 2005, respectively. Since inception of the Debt Optimization Program, prepayments to the U.S. Treasury have increased accumulated net revenues by $1.964 billion, $1.675 billion and $1.338 billion at Sept. 30, 2007, 2006 and 2005, respectively.

Calculations for modified net revenues were developed as part of the power rates for the current period and were used to determine the thresholds for the CRAC. The primary change in modified net revenues from fiscal year 2005 through fiscal years 2006 and 2007 is due to streamflows and market prices as discussed above.

Fish & 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 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 as threatened or endangered,

Fish and Wildlife

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

	2007	2006	2005
Direct costs	**$ 313,000**	$ 286,000	$ 283,000
Operational impacts:			
Replacement power purchases	**121,000**	168,000	111,000
Estimated foregone power revenues	**282,000**	398,000	182,000
Total fish and wildlife	**$ 716,000**	$ 852,000	$ 576,000

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

BPA typically funds fish and wildlife mitigation through several mechanisms. Since the creation of the Federal Columbia River Power System, 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. Such measures affect the operation of the FCRPS, reducing power generation, and either requires 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. To the extent that this comparison indicates that: 1) 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 2) BPA power revenues are less than would have been earned absent changes in hydroelectric system operations attributable to fish and wildlife, BPA accounts for such value as a fish and wildlife cost.

Forward-Looking Information

Endangered Species Act

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

Environmental

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

President's Fiscal Year 2008 Budget

The President's fiscal year 2008 budget includes two proposals that, if implemented, may affect BPA. First, the budget proposes that, starting in fiscal year 2008, in any year that BPA earns net secondary revenues in excess of $500 million, BPA shall pay an amount equivalent to that excess to the U.S. Treasury as early payment toward Treasury bond debt. Net secondary revenues are the revenues (net of transmission and generation costs) that BPA derives from the sale of secondary energy inside and outside of the Pacific Northwest. These revenues are highly variable depending on water availability and market prices. As proposed in the budget, no change in law would be required for BPA to implement the proposal regarding net secondary revenues. The budget proposal would have to be implemented in a BPA rate case proceeding. Since the President's budget was released, however, Congress passed a law that forbids BPA and other federal agencies as of Sept. 30, 2007, from expending funds to make, or plan or prepare to make, any advance payment on BPA debt. This legislation allows the region time for sufficient dialogue regarding this budget proposal before it is implemented and prohibits any actions on the part of BPA to begin implementation of the proposal. Second, the budget provides that next year after Energy Northwest issues refinancing bonds under the Debt Optimization Program, BPA will use amounts in the Bonneville Fund that otherwise would have been used to meet the higher assumed debt service level in such year of the refinanced Energy Northwest bonds to make additional payments on its federal debt. Prior to the fiscal year 2007 President's Budget, BPA had not assumed Energy Northwest refinancing activity under the Debt Optimization Program or additional associated federal payments until Energy Northwest made appropriate Debt Optimization Program assumptions in its budget process. While this is a different budget treatment than in the past, this treatment does not alter plans for BPA's Debt Optimization Program.

Combined Balance Sheets

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

ASSETS

	2007	2006
Federal utility plant		
Completed plant	**$ 13,278,856**	$ 13,056,815
Accumulated depreciation	**(4,825,295)**	(4,652,107)
	8,453,561	8,404,708
Construction work in progress	**851,620**	795,151
Net federal utility plant	**9,305,181**	9,199,859
Nonfederal generation	**2,465,230**	2,435,065
Current assets		
Cash	**1,475,544**	1,225,075
Accounts receivable, net of allowance	**140,335**	137,179
Accrued unbilled revenues	**181,526**	247,418
Materials and supplies, at average cost	**68,334**	71,765
Prepaid expenses	**19,938**	21,453
Total current assets	**1,885,677**	1,702,890
Other assets		
Regulatory assets	**5,938,724**	6,217,712
Nonfederal nuclear decommissioning trusts	**162,438**	140,896
Deferred charges and other	**206,398**	101,024
Total other assets	**6,307,560**	6,459,632
Total assets	**$ 19,963,648**	$ 19,797,446

The accompanying notes are an integral part of these statements.

CAPITALIZATION AND LIABILITIES

	2007	2006
Capitalization and long-term liabilities		
Accumulated net revenues	**$ 2,402,565**	$ 1,945,357
Federal appropriations	**4,326,688**	4,290,035
Bonds issued to U.S. Treasury	**1,760,900**	1,925,500
Nonfederal debt	**6,262,295**	6,284,379
Total capitalization and long-term liabilities	**14,752,448**	14,445,271
Commitments and contingencies (Note 9)		
Current liabilities		
Federal appropriations	**10,913**	33,694
Bonds issued to U.S. Treasury	**479,600**	556,300
Nonfederal debt	**288,758**	230,879
Accounts payable and other	**346,352**	369,597
Total current liabilities	**1,125,623**	1,190,470
Other Liabilities		
Regulatory liabilities	**2,050,228**	2,072,362
IOU exchange benefits	**1,068,217**	1,224,198
Asset retirement obligations	**175,500**	169,300
Deferred credits	**791,632**	695,845
Total other liabilities	**4,085,577**	4,161,705
Total Capitalization and Liabilities	**$19,963,648**	$19,797,446

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

	2007	2006	2005
Operating revenues			
Sales	**$ 3,136,216**	$ 3,370,432	$ 3,051,976
SFAS 133 derivative mark-to-market	**(6,519)**	(100,093)	94,596
Miscellaneous revenues	**72,846**	72,677	63,811
U.S. Treasury credits for fish	**66,097**	76,353	57,700
Total operating revenues	**3,268,640**	3,419,369	3,268,083
Operating expenses			
Operations and maintenance	**1,569,504**	1,320,880	1,256,576
Purchased power	**310,073**	535,020	580,213
Nonfederal projects	**343,321**	337,627	291,540
Depreciation and amortization	**351,787**	353,236	375,600
Total operating expenses	**2,574,685**	2,546,763	2,503,929
Net operating revenues	**693,955**	872,606	764,154
Interest (income) and expense			
Interest on federal investment:			
Appropriated funds	**214,215**	204,979	192,110
Bonds issued to U.S. Treasury	**130,164**	135,607	141,622
Allowance for funds used during construction	**(33,172)**	(28,514)	(16,903)
Interest income	**(74,460)**	(50,529)	(39,545)
Net interest expense	**236,747**	261,543	277,284
Net revenues	**$ 457,208**	$ 611,063	$ 486,870

The accompanying notes are an integral part of these statements.

Combined Statements of Changes in Capitalization and Long-Term Liabilities

Federal Columbia River Power System

Including current portions — thousands of dollars

	Accumulated Net Revenues	Federal Appropriations	Bonds Issued to Treasury	Nonfederal Debt	Total
Balance at Sept. 30, 2005	$ 1,334,294	$ 4,341,601	$2,776,800	$6,494,049	$14,946,744
Federal appropriations:					
Increase for construction	—	83,351	—	—	83,351
Repayment of construction	—	(101,223)	—	—	(101,223)
Bonds issued to U.S. Treasury:					
Increase	—	—	270,000	—	270,000
Repayment	—	—	(545,000)	—	(545,000)
Refinanced	—	—	(20,000)	—	(20,000)
Nonfederal debt:					
Net increase	—	—	—	36,581	36,581
Repayment	—	—	—	(15,372)	(15,372)
Net revenues	611,063	—	—	—	611,063
Balance at Sept. 30, 2006	$ 1,945,357	$ 4,323,729	$2,481,800	$6,515,258	$15,266,144
Federal appropriations:					
Increase for construction	**—**	**125,972**	**—**	**—**	**125,972**
Repayment of construction	**—**	**(112,100)**	**—**	**—**	**(112,100)**
Bonds issued to U.S. Treasury:					
Increase	**—**	**—**	**315,000**	**—**	**315,000**
Repayment	**—**	**—**	**(506,300)**	**—**	**(506,300)**
Refinanced	**—**	**—**	**(50,000)**	**—**	**(50,000)**
Nonfederal debt:					
Increase	**—**	**—**	**—**	**66,148**	**66,148**
Repayment	**—**	**—**	**—**	**(30,353)**	**(30,353)**
Net revenues	**457,208**	**—**	**—**	**—**	**457,208**
Balance at Sept. 30, 2007	**$ 2,402,565**	**$ 4,337,601**	**$2,240,500**	**$6,551,053**	**$15,531,719**

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

	2007	2006	2005
Cash provided by operating activities			
Net revenues	**$ 457,208**	$ 611,063	$ 486,870
Non-cash items:			
Federal projects depreciation and amortization	**351,787**	353,236	375,600
Amortization of capitalization adjustment	**(64,905)**	(64,905)	(64,905)
Changes in:			
Receivables and unbilled revenues	**62,736**	(87,612)	(47,394)
Materials and supplies	**3,431**	3,308	6,173
Prepaid expenses	**1,515**	299,579	10,351
Accounts payable and other	**(23,245)**	47,100	(16,370)
Other	**83,758**	151,323	(72,832)
Cash provided by operating activities	**872,285**	1,313,092	677,493
Cash provided by and (used for) investment activities			
Investment in:			
Federal utility plant (including AFUDC)	**(435,758)**	(402,474)	(424,735)
Nonfederal projects	**(30,165)**	(45,620)	(40,221)
Conservation and fish and wildlife	—	—	(29,400)
Transfer from Spectrum Relocation Fund	**48,627**	—	—
Nonfederal nuclear decommissioning trusts	**(6,691)**	—	—
Special purpose corporation's trust funds:			
Deposits to	**(51,070)**	—	—
Receipts from	**5,955**	—	—
Cash used for investment activities	**(469,102)**	(448,094)	(494,356)
Cash provided by and (used for) financing activities			
Federal construction appropriations:			
Increase	**125,972**	83,351	75,642
Repayment	**(112,100)**	(101,223)	(178,002)
Bonds issued to U.S. Treasury:			
Increase	**315,000**	270,000	315,000
Repayment	**(506,300)**	(545,000)	(438,500)
Refinanced	**(50,000)**	(20,000)	—
Nonfederal debt:			
Increase	**66,148**	36,581	47,513
Repayment	**(30,353)**	(15,372)	(7,292)
Customer's advances for construction	**38,919**	—	—
Cash used for financing activities	**(152,714)**	(291,663)	(185,639)
Increase (decrease) in cash	**250,469**	573,335	(2,502)
Beginning cash balance	**1,225,075**	651,740	654,242
Ending cash balance	**$1,475,544**	$1,225,075	$ 651,740
Cash paid for interest, net of U.S. Treasury credits	**$ 243,010**	$ 256,787	$ 295,756

The accompanying notes are an integral part of these statements.

1. Summary of Significant Accounting Policies

Accounting Principles

Combination and Consolidation of Entities

The Federal Columbia River Power System (FCRPS) combines the accounts of the Bonneville Power Administration (BPA), the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation), and the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan facilities. Each of the foregoing entities is separately managed and financed, but the facilities are operated as an integrated power system with the financial results combined as the FCRPS.

BPA is the power marketing administration that purchases, transmits and markets power for the FCRPS. The costs of multipurpose Corps and Reclamation projects are assigned to specific functions through a cost-allocation process. Only the portion of total project costs allocated to power is included in these statements. All material inter-company accounts and transactions have been eliminated from the combined financial statements. Northwest Infrastructure Financing Corporation (NIFC) and Northwest Infrastructure Financing Corporation II (NIFC II) are both "Special Purpose Corporations" whose financial records are consolidated with BPA's accounts (See Note 7, Nonfederal Debt).

FCRPS accounts are maintained in accordance with generally accepted accounting principles and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission. FCRPS accounting policies also reflect specific legislation and executive directives issued by U.S. government departments. BPA is a unit of the U.S. Department of Energy; Reclamation and U.S. Fish and Wildlife Service are part of the U.S. Department of the Interior; and the Corps is part of the U.S. Department of Defense. U.S. government properties and income are tax-exempt.

Use of Estimates

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

Reclassifications

Certain reclassifications were made to the fiscal years 2005 and 2006 Combined Statements of Revenues and Expenses from amounts previously reported to conform to the presentation used in fiscal year 2007. Interest income on the Bonneville Fund cash balance is shown separately. Previously interest on bonds issued to the U.S. Treasury was reported net of the interest income. These reclassifications had no effect on previously reported results of operations and of cash flows.

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 the Federal Energy Regulatory Commission (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. FERC reviews all BPA power and transmission rates. 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. It is the opinion of BPA's General Counsel that, if a rate were rejected, it would be remanded to BPA for reformulation.

In connection with the rate setting process, certain costs or credits may be included in rates for recovery over a future period. Under those circumstances, regulatory assets or liabilities are recorded; such costs or credits are amortized over the periods they are included in rates 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).

In fiscal year 2006, BPA submitted to FERC a power rate filing for fiscal years 2007 through 2009. BPA has received interim approval of those rates effective Oct. 1, 2006. In fiscal year 2001, BPA submitted to FERC a Power Rate Filing for fiscal years 2002 through 2006. FERC granted final approval of that filing on July 21, 2003.

The rates effective as of Oct. 1, 2006, for fiscal years 2007 through 2009 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 to ensure that BPA has sufficient funds to meet its obligations, including repayment to the U.S. Treasury. The CRAC is triggered if the generation function's forecast level of accumulated modified net revenues (as defined in the General Rate Schedule Provisions) is below a predetermined threshold. The rates also contain an NFB[1] Adjustment, which allows an increase to the CRAC cap by the amount of additional costs needed to resolve potential litigation over the 2004 Biological Opinion. Power rates also include an NFB Emergency Surcharge for a qualifying within-year adjustment triggered by the same Biological Opinion events as the Surcharge, and a Dividend Distribution Clause that is triggered if the generation function's forecast levels of accumulated modified net revenues exceed a predetermined threshold.

The prior power rates included three CRACs each triggered by a different set of conditions. The first was the Load-Based CRAC, which triggered if BPA incurred costs for loads not included in the rate case. The second was the Financial-Based CRAC, which triggered if the generation function's forecast level of accumulated modified net revenues (as defined in the General Rate Schedule

[1] National Marine Fisheries Service Federal Columbia River Power System Biological Opinion

Provisions) was below a predetermined threshold. Both the LB and FB CRACs were in effect during fiscal years 2005 and 2006. The third was the Safety Net CRAC, which triggered if BPA forecast a 50 percent or greater probability of missing a payment to the U.S. Treasury or another creditor. The SN CRAC was not triggered for fiscal year 2005; however in late 2005 it was triggered and became effective during fiscal year 2006.

In fiscal year 2005, BPA submitted a Transmission and Ancillary Services Rate Filing for fiscal years 2006 through 2007, for which FERC granted final approval on Sept. 29, 2005. In fiscal year 2003, BPA submitted a Transmission and Ancillary Services Rate Filing for fiscal years 2004 through 2005, for which FERC granted final approval on Sept. 23, 2003.

Federal Utility Plant

Federal utility plant is stated at original cost. Cost includes direct labor and materials; payments to contractors; indirect charges for engineering, supervision and similar overhead items and an allowance for funds used during construction. The costs of additions, major replacements and betterments are capitalized. Maintenance, repairs and replacements of items determined to be less than 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 any 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.

AFUDC has two rates, one for Corps and Reclamation construction funded by congressional appropriations and the other for construction directly funded by BPA. AFUDC rates for Corps and Reclamation construction projects are stipulated in the congressional acts authorizing the construction and the BPA rate approximates the cost of borrowing from the U.S. Treasury.

The respective rates were approximately 5.1 percent and 5.1 percent in fiscal year 2007, 3.9 percent and 4.8 percent in fiscal year 2006, and 2.1 percent and 4.9 percent in fiscal year 2005.

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 7, 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

The carrying value reflected in the Combined Balance Sheets approximates fair value for the FCRPS' financial assets and current liabilities. The fair value of bonds issued to the U.S. Treasury and issued for nonfederal debt are described in Notes 6 and 7, Bonds Issued to 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 receivables are spread across a diverse group of public utilities, investor-owned utilities, power marketers and others that are geographically located throughout the Western United States and Canada. The accounts receivables 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 2007, 2006 and 2005, 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 receivables 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 are 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 2007, 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 9, 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.

SFAS 133 Derivative Mark-to-Market

BPA follows the provisions of Statement of Financial Accounting Standards (SFAS) 133, "Accounting for Derivative Instrument and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 133 requires that every derivative instrument be recorded on the balance sheet as an asset or liability measured at its fair value and 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 Consolidated 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 SFAS 133 mark-to-market unrealized (loss) gain in the Combined Statements of Revenues and Expenses related to its derivative portfolio (including physical power purchase and sale transactions, power exchange transactions, and interest rate swap transactions) of $(6.5) million, $(100.1) million and $94.6 million for fiscal years 2007, 2006 and 2005, 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 $(2.2) million unrealized fair value loss, an $8.4 million unrealized fair value gain, and a $4.3 million unrealized fair value gain in the Combined Statements of Revenues and Expenses for fiscal years 2007, 2006 and 2005 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 $182 million, $247 million and $209 million at Sept. 30, 2007, 2006 and 2005, respectively. BPA operates the Power Services segment and the Transmission Services segment. In Note 10, Segments, the table reflects revenues and expenses attributable to each service segment.

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 9, 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 bonds issued 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 at the bottom of 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.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board issued SFAS 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. As currently defined the provisions of SFAS 157 are effective for BPA in fiscal year 2009. BPA is evaluating the effect of the 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 Financial Accounting Standards Board 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.

2. Asset Retirement Obligations

Asset retirement obligations (AROs) represent legal obligations related to dismantlement and restoration costs that are associated with the retirement of tangible long-lived assets. FCRPS has recognized AROs in accordance with SFAS 143, "Accounting for Asset Retirement Obligations," and in accordance with Financial Accounting Standards Board Interpretation 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations." FIN 47 clarifies that if an entity can reasonably estimate the fair value of an ARO, then the entity must recognize a liability even though the timing and/or method of settlement are conditional on a future event.

AROs Activity

For the years ended Sept. 30 — thousands of dollars

	2007	2006
Beginning Balance	**$169,300**	$160,600
Activities:		
Additions	—	3,500
Expenditures	**(1,800)**	(2,000)
Accretion	**7,900**	7,400
Revisions	**100**	(200)
Ending Balance	**$175,500**	$169,300

FCRPS recognizes an ARO liability according to the estimated fair value. The liability is later adjusted for any revisions to the expected value of the ARO and also adjusted for accretion of the liability due to the passage of time. FCRPS also has certain tangible long-lived assets such as federal hydro projects without an associated ARO.

The AROs for Columbia Generating Station decommissioning and site restoration, Project Nos. 1 and 4 site restoration, Trojan decommissioning, and BPA's PCBs, asbestos, and wood poles are $175.5 million and $169.3 million at Sept. 30, 2007 and 2006, respectively. At Sept. 30, 2007, BPA has recorded estimated liabilities on a fair value basis of $108.7 million for CGS decommissioning and site restoration; $49.2 million for Trojan decommissioning; $13.9 million for Project Nos. 1 and 4 site restoration; and $3.7 million for BPA's PCBs, asbestos and wood poles.

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 requirements. The NRC requires that this period be no longer than 60 years. Trust fund requirements for CGS are based on a NRC decommissioning cost estimate and assume a 60-year operating life.

BPA has funded $162.4 million for the Energy Northwest AROs, which is held in trusts and recorded in other assets on the Combined Balance Sheet at Sept. 30, 2007. The trust fund balances are $122.7 million and $39.7 million for decommissioning and site restoration, respectively at Sept. 30, 2007. Payments to the trusts for fiscal years 2007, 2006 and 2005 were approximately $6.7 million, $6.2 million and $5.5 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

Regulatory Assets and Liabilities

BPA defers costs as regulatory assets such that costs will be recovered through rates during the periods when the costs are scheduled to be repaid. Amortization is computed using the straight-line method based upon either the estimated service lives or the periods the costs are included in rates; or based upon specific amounts included in rates each year. BPA does not earn a rate of return on its regulatory assets. BPA defers credits as regulatory liabilities in connection with the rate setting process.

Regulatory Assets and Liabilities

As of Sept. 30 — thousands of dollars

	2007	2006
Regulatory Assets		
Terminated nuclear facilities	**$ 3,856,265**	$3,897,275
IOU residential exchange benefits	**885,231**	1,206,539
Columbia River Fish Mitigation	**366,969**	330,244
Conservation measures	**228,213**	271,934
Direct-service industries benefits	**226,464**	177,000
Fish and wildlife measures	**148,514**	128,906
Trojan decommissioning and site restoration	**49,196**	24,876
Settlements	**47,032**	54,423
Federal Employees' Compensation Act	**37,241**	33,388
Sponsored conservation	**33,276**	36,847
Terminated hydro facilities	**25,625**	26,485
Spacer damper replacement program	**19,200**	10,784
Capital bond premiums	**15,498**	19,011
Total Regulatory Assets	**5,938,724**	6,217,712
Regulatory Liabilities		
Capitalization adjustment	**1,861,416**	1,926,321
Accumulated plant removal costs	**140,248**	132,179
CGS decommissioning and sites restoration	**39,821**	—
Other	**8,743**	13,862
Total Regulatory Liabilities	**2,050,228**	2,072,362
Net Regulatory Assets and Liabilities	**$ 3,888,496**	$4,145,350

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 7, Nonfederal Debt).

– "Investor-owned utility residential exchange benefits" reflect costs that will be recovered through rates (See Note 8, Other Liabilities).

– "Columbia River Fish Mitigation" is the cost of research and development for fish bypass facilities funded through appropriations since 1989 in accordance with the Energy and Water Development Appropriations Act 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 2008 through 2011.
- “Fish and wildlife measures” consist of the capitalized fish and wildlife projects and are amortized over a period of 15 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).
- “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.
- “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.
- “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.
- “Capital bond premiums” are the deferred losses related to refinanced debt and are amortized over the life of the new debt instruments.

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 Recissions 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 2007, 2006 and 2005, respectively.
- “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 site restoration and will be amortized as actual removal costs are incurred.
- “Other” is the amount collected through billing settlements, which reduces future rates.

4. Deferred Charges and Other

Deferred Charges and Other includes the various assets described below.

Deferred Charges and Other

As of Sept. 30 — thousands of dollars

	2007	2006
SFAS 133 derivative mark-to-market	**$ 50,443**	$ 57,113
Special purpose corporation's trust funds	**64,907**	21,581
Spectrum Relocation fund	**47,241**	—
Energy receivable	**18,314**	13,801
Other	**25,493**	8,529
	$ 206,398	$101,024

- "SFAS 133 derivative mark-to-market" represents unrealized fair value gains of derivative contracts.
- "Special purpose corporation's trust funds" are amounts held in separate trust accounts primarily for the construction of various transmission assets. In December 2005, BPA energized the Schultz-Wautoma transmission line that was financed by Northwest Infrastructure Financing Corporation. In June 2007, BPA entered into a master lease agreement with NIFC II under which BPA agreed to lease and to construct various transmission assets.
- 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 a prior transmission line loss and over delivery.
- "Other" is primarily Corps and Reclamation costs for generating assets not placed in service.

5. 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). Maturing federal appropriations includes payments on historic replacements but excludes planned future replacements and irrigation assistance.

Maturing Federal Appropriations

As of Sept. 30 — thousands of dollars

2008	$ 10,913
2009	9,889
2010	3,784
2011	21,232
2012	24,622
2013 and thereafter	4,267,161
	$ 4,337,601

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, 2007.

6. Bonds Issued to U.S. Treasury

Maturing Bonds Issued to U.S. Treasury

As of Sept. 30 — thousands of dollars

2008	$ 479,600
2009	440,400
2010	365,000
2011	135,000
2012	40,000
2013 through 2037	780,500
	$2,240,500

To finance its capital programs including Corps and Reclamation direct-funded capital investments, BPA is authorized by Congress to issue to the U.S. Treasury up to $4.45 billion of interest-bearing debt with terms and conditions comparable to debt issued by U.S. government corporations. Of the $4.45 billion, $1.25 billion is reserved for conservation and renewable resource loans and grants.

At Sept. 30, 2007, of the total $2.24 billion of outstanding bonds, $754.8 million were conservation and renewable resource loans and grants (including Corps, Reclamation and U.S. Fish and Wildlife Service capital investments). The average interest rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently. As a result, the fair value of BPA bonds issued to the U.S. Treasury exceeds the carrying value by approximately $153 million and $132 million, based on discounted future cash flows using rates offered by the U.S. Treasury as of Sept. 30, 2007, and Sept. 30, 2006, respectively, for similar maturities.

The weighted average interest rate was 5.4 percent and 5.1 percent on outstanding bonds issued to the U.S. Treasury as of Sept. 30, 2007 and 2006.

7. Nonfederal Debt

Maturing Nonfederal Debt

As of Sept. 30 — thousands of dollars

2008	$ 288,758
2009	281,222
2010	287,312
2011	282,674
2012	441,357
2013 and thereafter	4,969,730
	$6,551,053

In addition to the Columbia Generating Station nuclear generating project, BPA has also acquired all or part of the generating capability of three other nuclear projects that are not providing power. These other projects are Energy Northwest Nuclear Project No. 1, 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 is proceeding in decommissioning the Trojan project.

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

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

Nonfederal Debt by Project

As of Sept. 30 — thousands of dollars

	2007	2006
Columbia Generating Station	**$ 2,327,420**	$ 2,292,555
Nuclear Project No. 1	**1,938,640**	1,961,960
Nuclear Project No. 3	**1,909,430**	1,919,315
Cowlitz Falls	**137,810**	142,510
Schultz Wautoma	**119,587**	119,587
NIFC II	**51,070**	—
Wasco	**25,625**	26,485
CARES	**20,520**	22,590
Tacoma	**12,315**	13,580
Trojan	**8,195**	16,000
Emerald	**441**	676
	$ 6,551,053	$ 6,515,258

The debt for both the operating and nonoperating nonfederal projects is included in nonfederal debt. BPA recognizes expenses for these projects based upon total project cash funding requirements. Related assets for operating projects are included in nonfederal generation. Nonoperating projects are included in regulatory assets.

BPA has entered into separate capitalized lease purchase arrangements with two special purpose corporations, Northwest Infrastructure Financing Corporation and Northwest Infrastructure Financing Corporation II. The leases allow BPA to continue to transmit reliable, low-cost power to ratepayers throughout the Pacific Northwest.

Under the transaction with NIFC, BPA is leasing the Schultz-Wautoma transmission line. The line construction costs were financed by NIFC through a taxable bond issuance totaling $119.6 million. NIFC owns the line and has leased it to BPA for a period of 30 years. At the expiration of the lease, BPA may purchase the line for a bargain purchase price.

In June 2007, BPA entered into an umbrella lease and several lease purchase commitments with NIFC II for individual transmission assets having an estimated cost to construct totaling $51.1 million in aggregate. The construction costs of the assets are being financed through a bank line of credit between NIFC II and Citibank. NIFC II owns the assets and has leased them to BPA until fiscal year 2014, at which point BPA may acquire the assets for a bargain purchase price.

NIFC and NIFC II have been consolidated under FIN 46 into the BPA financial statements since their inceptions. The bonds and bank line of credit are included in nonfederal debt on the FCRPS statements.

The fair value of Energy Northwest debt exceeds recorded value by $303 million and $349 million, as of Sept. 30, 2007, and Sept. 30, 2006, respectively. The valuations are based on discounted future cash flows using interest rates for similar debt which could have been issued at Sept. 30, 2007, and Sept. 30, 2006, respectively. The weighted average interest rate was 5.3 percent on the major portion of outstanding nonfederal debt as of Sept. 30, 2007.

Operating and maintenance expense for the projects of $290 million, $243 million and $257 million in fiscal years 2007, 2006 and 2005, respectively, is included in operations and maintenance in the accompanying Combined Statements of Revenues and Expenses. Debt service for the projects of $343 million, $338 million and $292 million for fiscal years 2007, 2006 and 2005, respectively, is reflected as nonfederal expense in the accompanying Combined Statements of Revenues and Expenses.

8. Other Liabilities

IOU Residential Exchange Benefits

As provided in the Northwest Power Act, beginning in 1982 BPA entered into 20-year Residential Purchase and Sale Agreements (RPSA) with eligible regional utility customers. The RPSAs implemented the Residential Exchange Program. BPA signed Residential Exchange Settlement Agreements with the region's six investor-owned utilities (IOU), 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. The later agreements and amendments (referred to herein as the Supplemental Agreements) provided for minimum and cap amounts for the IOUs' monetary benefits for fiscal years 2007 through 2011, provided that BPA had no obligation to provide power to the IOUs in such period, and also provided for the elimination or deferral of certain payments during that period.

The IOU Residential Exchange benefits liability is in question because of a recent ruling by the United States Court of Appeals for the Ninth Circuit (Ninth Circuit Court). The ruling invalidated the Residential Exchange Settlement Agreements and directed BPA to set power rates consistent with applicable law and the court's opinion. (See Note 9, Commitments and Contingencies, for additional details).

Prior to the court's ruling, BPA had set its power rates for the three fiscal years beginning with FY 2007 on the basis of financial assumptions derived from the terms of the foregoing agreements and amendments. While the ruling raises questions regarding the amount of payments that BPA will make to the IOUs, if any, BPA believes that the amount recorded will ultimately be incurred, whether by payment to the IOUs and/or by some form of return to other ratepayers. In view of the order of remand, BPA's FY 2007 obligations with respect to the Residential Exchange Program will not be determined until BPA completes rate proceedings that will occur during FY 2008.

As of Sept. 30, 2007, BPA's Combined Balance Sheet amount of $1.068 billion includes liabilities in the amount of $168 million for the suspended settlement payments for the last half of fiscal year 2007; $600 million for IOU exchange benefits for fiscal years 2008 through 2009 (recorded at the cap amount of $300 million per year); $200 million for IOU exchange benefits for fiscal years 2010 and 2011 (recorded at the annual floor of $100 million, until the amount can be reasonably estimated, which is expected to occur after BPA proposes power rates for the fiscal year 2010-2011 rate period); and $100 million for certain risk contingency payments and certain deferred payment obligations to IOUs, in each case as BPA agreed under certain of the Supplemental Agreements. The final amount of such aggregate liability could differ substantially from the amount of benefit payments that BPA currently recognizes for fiscal year 2007 and will not be known until the definitive level of benefits is determined through the rate setting process. The amounts to be collected through future rates are included in corresponding regulatory assets of $885 million.

BPA remains obligated to offer RPSA contracts to eligible utilities. Given the uncertainties associated with this matter, it is not clear whether any financial settlements of prior payments will occur or whether such settlements will result in a direct liability to the agency. As such no changes have been made to the recorded liability.

Deferred Credits

As of Sept. 30 — thousands of dollars

	2007	2006
Customer reimbursable projects	**$ 233,849**	$ 205,238
DSI benefits	**226,464**	177,000
Third AC intertie capacity agreements	**110,350**	113,416
Large generation interconnection agreements	**69,110**	46,714
Fiber optic leasing fees	**46,301**	49,951
Federal Employees' Compensation Act	**37,241**	33,388
Settlements	**33,500**	38,500
Capital leases	**19,020**	19,454
Other	**15,797**	12,184
	$ 791,632	$ 695,845

Deferred Credits

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

- "Customer reimbursable projects" consist of advances received from customers where either the customer or BPA will own the resulting asset. If the customer will own the asset under construction, the revenue is recognized as the expenditures are incurred. If BPA will own the resulting asset, 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 2008 through 2011. The contracts became effective on Oct. 1, 2006, and continue in effect through Sept. 30, 2011.

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

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

- "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 9, Commitments and Contingencies).

- "Capital leases" represent BPA's long-term portion of capital lease liabilities for Goshen-Drummond and Lower Valley-Teton transmission lines.

- "Other" consists of miscellaneous liabilities not identified above.

9. Commitments and Contingencies

Firm Purchase Power and Sale Commitments

As of Sept. 30 — thousands of dollars

	Purchases	Sales
2008	$ 53,696	$1,974,792
2009	48,391	1,992,033
2010	23,024	2,022,727
2011	24,439	1,997,238
	$149,550	**$7,986,790**

Subscription contracts are the basis for the contractual relationship between BPA and its preference customers. These contracts expire by Sept. 30, 2011. BPA enters into 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.

Irrigation Assistance

As of Sept. 30 — thousands of dollars

	Scheduled Distributions
2008	$ 2,950
2009	7,279
2010	—
2011	—
2012	1,201
2013 and thereafter	677,793
	$689,223

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 $689 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

As of Sept. 30 — thousands of dollars

	Future Contributions*
2008	$ 18,000
2009	30,554
2010	31,195
2011	32,142
2012	32,791
	$144,682

* Amount for fiscal year 2008 is scheduled. Later fiscal years are estimates.

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. The payment for fiscal year 2007 included both the full amount of FCRPS' current year obligation to cover payments for the underfunded programs, as well as the final payment for costs that were deferred from fiscal years 1998 through 2001. The deferred amounts had been recorded as a regulatory asset and a related deferred credit on the Combined Balance Sheets, but as of Sept. 30, 2007, have been fully satisfied and therefore reduced to zero. BPA paid $21.1 million, $23.2 million and $26.5 million to the U.S. Treasury during fiscal years 2007, 2006 and 2005, respectively. 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 $7.2 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is $15.9 million. For the Business Interruption and/or Extra Expense Insurance policy, the maximum assessment is $4.7 million.

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

Environmental Matters

From time to time, there are sites for which BPA, Corps or Reclamation has been or may be identified as a potential responsible party. Costs associated with cleanup of those sites are not expected to be material to the FCRPS' financial statements and would be recoverable through rates. As such, no liability has been recorded.

Litigation

Slice

In 2003 certain BPA customers and customer groups filed petitions with the United States Court of Appeals for the Ninth Circuit (Ninth Circuit Court) challenging BPA's final 2002 Slice true-up adjustment charge determinations under the Slice Agreements. The Slice true-up charge is an annual adjustment to the Slice Rate. In addition, in March 2004 petitions for review were filed challenging BPA's 2003 Slice true-up adjustment charge. A settlement agreement was executed by all parties on Nov. 22, 2006, covering Slice true-ups for 2002, 2003, 2004 and 2005. BPA credited the $26.2 million settlement payment to Slice customer bills (related to fiscal years 2002-2005) and billed $7 million (related to fiscal year 2006) to be returned to BPA by Slice customers. These cases are now resolved.

Residential Exchange Program

In connection with the implementation of post-2001 power sales agreements, BPA prepared draft Residential Purchase and Sale Agreements and tendered the form of such agreements to the regional IOUs for their consideration and possible execution. The draft RPSAs proposed to define BPA's statutory obligations under the Residential Exchange Program provisions of the Northwest Power Act for the 10-year period beginning Oct. 1, 2001. During the same timeframe, BPA negotiated certain agreements (Residential Exchange Settlement Agreements) with regional IOUs to settle BPA's statutory Residential Exchange Program obligation under such agreements in lieu of the RPSAs for the five and/or 10-year period beginning Oct. 1, 2001. In October 2000, all six regional IOUs entered into the Residential Exchange Settlement Agreements in lieu of the RPSAs.

A number of BPA's customers and customer groups filed petitions with the Ninth Circuit Court seeking review of the RPSAs and the Residential Exchange Settlement Agreements and the related records of decisions prepared by BPA. A number of interventions were also filed in the foregoing challenges, and the various petitions were consolidated, with the lead case known as Portland General Electric, et al. v. BPA (PGE). In addition, certain BPA customers and customer groups filed petitions challenging certain aspects of BPA's fiscal year 2002-2006 wholesale power rates, including challenges to BPA's allocation of costs of the Residential Exchange Settlement Agreements to the base rate applicable to power sales made to BPA's public preference customers (the Priority Firm Power Rate). These various petitions were likewise consolidated, with the lead case known as Golden Northwest Aluminum Co., et al. v. BPA (Golden Northwest).

On May 3, 2007, the Ninth Circuit Court issued opinions in these cases. In the PGE case, the Court held that the Residential Exchange Settlement Agreements are not consistent with the Northwest Power Act, which established the Residential Exchange Program.

In the Golden Northwest case, the Court cited its ruling in the PGE case that found the Residential Exchange Settlement Agreements inconsistent with the Northwest Power Act, and concluded as a result of the PGE case that BPA improperly allocated costs of the settlements to the Priority Firm Power Rate. The court remanded to BPA to set rates in accordance with its opinion. BPA did not file a petition for rehearing in either case, but the IOUs did file such petitions on July 18, 2007. On Oct. 5, 2007, the Ninth Circuit Court issued an order denying all petitions for rehearing and rehearing en banc in the challenges to the settlement agreements with the IOUs.

In addition, subsequent to the execution of the Residential Exchange Settlement Agreements, BPA and the regional IOUs entered into a number of contract amendments and supplemental arrangements relating to the settlements. These amendments and supplemental arrangements increased the amount of cash payments that BPA would make with respect to the Residential Exchange Settlement Agreements while reducing the amount of physical power sales thereunder, and in some cases changed the timing of payments thereunder. A number of petitions for review were filed in the Ninth Circuit Court challenging aspects of these actions. The court requested and received a supplemental briefing regarding the manner in which the PGE and Golden Northwest opinions might affect the disposition of these challenges. On Oct. 11, 2007, the court issued an opinion in which it stated it lacked a sufficient record to rule on the issues presented by the petitions concerning a reduction of risk discount, and remanded to BPA to determine the status of the 2004 amendments in light of the court's opinion in the PGE case. Also on Oct. 11, 2007, the court dismissed for lack of jurisdiction two cases challenging a failed 2003 settlement, and dismissed as moot another challenge to the reduction of risk discount in BPA's 2001 Load Reduction Agreements with two investor-owned utilities.

As described in Note 8, Other Liabilities, BPA continues to record liabilities associated with the Residential Exchange Program comprising obligations for payments suspended in 2007 and estimated future obligations through 2011. Given the uncertainties associated with this matter, it is not clear whether any financial settlements of prior payments will occur or whether such settlements will result in a direct liability to the agency. As such no changes have been made to the recorded liability.

Southern California Edison

Southern California Edison 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 anticipates the escrowed funds will be disbursed 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 preference customers, 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 is scheduled for Nov. 7, 2007. 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. 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. BPA anticipates filing a responsive pleading in December 2007. In addition, the California parties filed a writ of certiorari in the above referenced Ninth Circuit Court case at the United States Supreme Court. The motions in opposition to the writ are due Nov. 8, 2007. BPA cannot determine at this time whether the claimed amount will ultimately be upheld. 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 2007.

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.

10. Segments

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

The FCRPS' major operating segments are defined by the utility functions of generation and transmission. The Power Services segment represents the operations of the generation function, while the Transmission Services segment represents the operations of the transmission function. The service segments are not separate legal entities. "Other" represents items that are necessary to reconcile to the financial statements. These items generally include shared activities such as debt management actions and inter-business unit eliminations. Debt service reassignment between Power Services and Transmission Services under the Debt Optimization Program resulted in $175 million, $210 million and $182 million of net revenues reported under "Other" for the fiscal years ended Sept. 30, 2007, Sept. 30, 2006, and Sept. 30, 2005, respectively.

The FCRPS segments operate predominantly in one industry and geographic region, generation and transmission of electric power in the Pacific Northwest.

The FCRPS centrally manages all interest expense activity and cash transactions. Unaffiliated revenues represent sales to external customers for each segment. Intersegment transactions are eliminated.

During fiscal years 2007, 2006 and 2005, no single customer represented 10 percent or more of the FCRPS' revenues.

Segment Reporting

For the years ended Sept. 30 — thousands of dollars

	Power	Transmission	Other	FCRPS
2007				
Unaffiliated revenues	**$2,579,353**	**$689,287**	**$ —**	**$ 3,268,640**
Intersegment revenues	**78,538**	**119,336**	**(197,874)**	**—**
Total operating revenues	**2,657,891**	**808,623**	**(197,874)**	**3,268,640**
Unaffiliated expenses	**2,061,378**	**294,018**	**(132,498)**	**2,222,898**
Depreciation	**176,204**	**175,583**	**—**	**351,787**
Intersegment expenses	**118,953**	**78,539**	**(197,492)**	**—**
Total operating expenses	**2,356,535**	**548,140**	**(329,990)**	**2,574,685**
Net operating revenues	**301,356**	**260,483**	**132,116**	**693,955**
Interest expense	**145,515**	**133,806**	**(42,574)**	**236,747**
Net revenues	**$ 155,841**	**$126,677**	**$ 174,690**	**$ 457,208**
2006				
Unaffiliated revenues	$2,778,237	$641,132	$ —	$ 3,419,369
Intersegment revenues	75,423	143,207	(218,630)	—
Total operating revenues	2,853,660	784,339	(218,630)	3,419,369
Unaffiliated expenses	2,067,497	303,450	(177,420)	2,193,527
Depreciation	181,878	171,358	—	353,236
Intersegment expenses	142,562	75,423	(217,985)	—
Total operating expenses	2,391,937	550,231	(395,405)	2,546,763
Net operating revenues	461,723	234,108	176,775	872,606
Interest expense	157,609	136,761	(32,827)	261,543
Net revenues	$ 304,114	$ 97,347	$ 209,602	$ 611,063
2005				
Unaffiliated revenues	$2,740,700	$527,383	$ —	$ 3,268,083
Intersegment revenues	73,524	107,147	(180,671)	—
Total operating revenues	2,814,224	634,530	(180,671)	3,268,083
Unaffiliated expenses	2,025,938	260,060	(157,669)	2,128,329
Depreciation	186,099	189,501	—	375,600
Intersegment expenses	106,510	73,524	(180,034)	—
Total operating expenses	2,318,547	523,085	(337,703)	2,503,929
Net operating revenues	495,677	111,445	157,032	764,154
Interest expense	166,610	135,754	(25,080)	277,284
Net revenues (expenses)	$ 329,067	$ (24,309)	$ 182,112	$ 486,870

REPORT OF INDEPENDENT AUDITORS

PRICEWATERHOUSECOOPERS

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

In our opinion, the accompanying combined balance sheets and the related combined statements of revenues and expenses, of changes in capitalization and long-term liabilities and of cash flows present fairly, in all material respects, the financial position of the Federal Columbia River Power System (FCRPS) at September 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years ended September 30, 2007, and the changes in its capitalization and long-term liabilities for each of the two years ended September 30, 2007, 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 26, 2007

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 through 2009 (see WP-07-FS-BPA-02) and the 2006 Final Transmission Rate Proposal in June 2005 for fiscal years 2006 through 2007 (see TR-06-FS-BPA-01). The final proposals filed with FERC contain the official amortization schedule for the rate periods.

Repayment Demonstration

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

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

Repayment Policy

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

1. Pay the cost of operating and maintaining the power system including payments related to the underfunded status of the CSRS plan.
2. Pay the cost of obtaining power through purchase and exchange agreements (nonfederal projects).
3. Pay interest on and repay outstanding bonds issued to the U.S. Treasury to finance transmission system construction, conservation, environmental, direct-funded Corps and Reclamation improvements, and fish and wildlife projects.
4. Pay interest on the unrepaid investment in facilities financed with appropriated funds. (Federal hydroelectric projects all were financed with appropriated funds, as were BPA transmission facilities constructed before 1978.)
5. Pay, with interest, any outstanding deferral of interest expense.
6. Repay the power investment in each federal hydroelectric project with interest within 50 years after the project is placed in service (except for the Chandler project, which has a legislated repayment period of 66 years).
7. Repay each increment of the investment in the BPA transmission system financed with appropriated funds with interest within the average service life of the associated transmission plant (40 years).
8. Repay the appropriated investment in each replacement at a federal hydroelectric project within its service life.
9. Repay construction costs at federal reclamation projects that are beyond the ability of the irrigators to pay and are assigned

for payment from commercial power net revenues within the same period available to the water users for making payments. These periods range from 40 to 66 years, with 50 years being applicable to most of the irrigation payment assistance.

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

Repayment Obligation

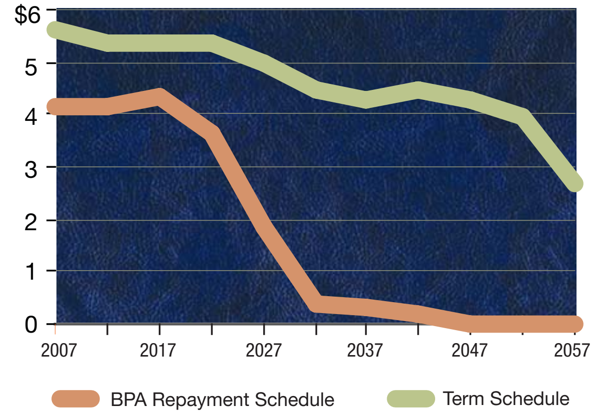
BPA's rates must be designed to collect sufficient revenues to return separately the power and transmission costs of each FCRPS investment and each irrigation assistance obligation within the time prescribed by law.

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

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

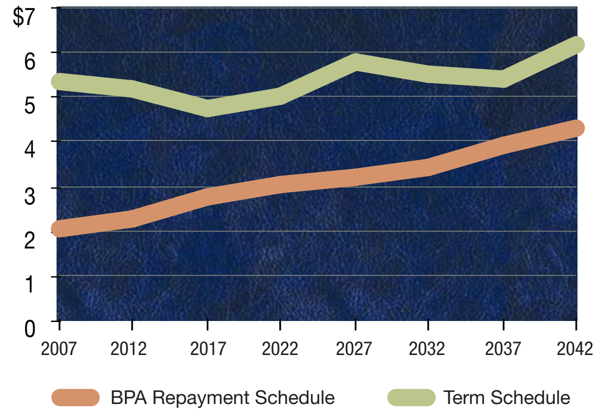
Unrepaid Federal Generation Investment

Includes future replacements – billions of dollars



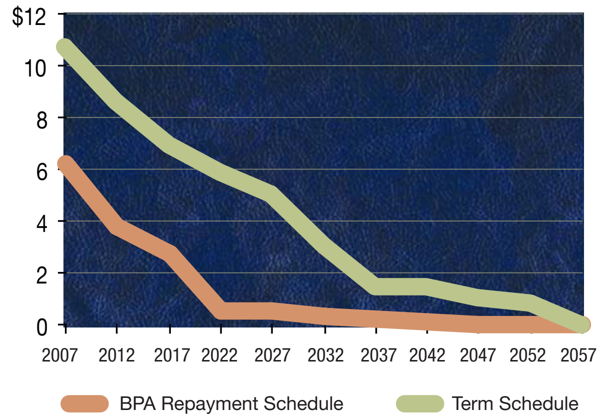
Unrepaid Federal Transmission Investment

Includes future replacements – billions of dollars



Unrepaid Federal Investment

Excludes future replacements – billions of dollars



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 through 2007 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.

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