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Energy Northwest, Washington Bonneville Power Administration, Oregon; Wholesale Electric

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Energy Northwest, Washington Bonneville Power Administration, Oregon; Wholesale Electric

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US\$740.965 mil columbia generating sta elec rev bnds (Bonneville Pwr Admin) ser 2012-E due 07/01/2027

<i>Long Term Rating</i>	AA-/Stable	New
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US\$34.565 mil columbia generating sta elec rev bnds (Bonneville Pwr Admin) ser 2012-D due 07/01/2044

<i>Long Term Rating</i>	AA-/Stable	New
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Conservation and Renewable Energy Sys, Washington

Bonneville Pwr Admin, Oregon

Conservation & Renewable Energy Sys (Bonneville Pwr Admin) conserv proj

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

Energy Northwest (Bonneville Pwr Admin) (1,Columbia,3)

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Rationale

Standard & Poor's Ratings Services has assigned its 'AA-' rating to Energy Northwest (ENW), Wash.'s proposed \$34.6 million Columbia Generating Station (CGS) electric revenue bonds, series 2012-D; and \$740.9 million series 2012-E (taxable). Bonneville Power Administration (BPA), Ore., will pay the bonds' debt service as an operating expenses of its electric system. At the same time, Standard & Poor's affirmed its 'AA-' rating on parity subordinate ENW obligations and the several nonfederal obligations that the BPA pays as operating expenses of its electric system. Standard & Poor's also affirmed its 'aa-' stand-alone credit profile on BPA. The outlook is stable.

Although the bonds are subordinate ENW obligations, the utility covenanted to close the prior lien. The \$263.6 million of closed-lien senior debt represents about 5% of the \$5.15 billion of ENW debt that BPA supports.

At fiscal year-end 2011 (Sept. 30), BPA had \$13.6 billion of debt obligations consisting of federal appropriations, bonds issued to the U.S. Treasury, and the nonfederal debt that Bonneville supports. The 2012-D and E bonds will increase federal and nonfederal obligations by nearly 6% and its nonfederal debt by about 13%, which we view as limiting this transaction's impact on BPA's credit profile.

We understand that Bonneville will treat debt service on the news bonds as operating expenses, as it does for debt service on the identically-rated \$5.5 billion of ENW and other nonfederal bonds. BPA pays nonfederal debt before servicing its \$7.3 billion of federal Treasury debt and appropriations.

Series 2012-D bond proceeds will finance CGS capital projects. Their amortization through 2044 approximates the nuclear plant's extended operating license. The 2012-E bonds will be amortized through 2027 and bond proceeds will

principally fund ENW's purchases of nuclear fuel from USEC Inc. (CCC+/Watch Neg/--). Proceeds of the 2012-E bonds will also fund issuance costs, capitalized interest, and some CGG capital projects.

ENW's contract with USEC provides for its purchase of 4.4 million separative work units (SWU) contained in 482 metric tons of enriched uranium hexafluoride. Enriched product, consisting of SWU and natural uranium, is a component of nuclear reactor fuel. BPA, through ENW, will pay USEC's fuel enrichment costs. BPA and ENW project savings from the multiparty transaction because the U.S. Department of Energy will furnish the raw material, depleted uranium hexafluoride, to USEC at no cost to the parties beyond nominal delivery costs.

ENW will retain and use only a modest portion of the USEC fuel it purchases. The fuel it keeps will produce electricity at its CGS. Notably, it has entered an agreement to sell most of the processed fuel to Tennessee Valley Authority (TVA), which will purchase 90% of the enriched product totaling 435.5 metric tons containing 72.5% of the SWU, equaling 2.9 million SWU. TVA is also supplying a quantity of natural uranium to USEC.

ENW will apply TVA's \$731 million of nuclear fuel payments to debt service on the 2012-E bonds. It projects that TVA's payments will cover about 84% of the debt service on the bonds. BPA's operating cash flow will cover the balance of the debt service. Because net billing agreements with ENW make BPA the bonds' obligor and it will rely on TVA revenues for a sizable portion of the 2012-E bonds' debt service, we view this structure as adding counterparty risk, as well as leverage, to BPA's stand-alone credit profile.

Although our 'CCC+' rating and negative CreditWatch listing on USEC underscore elements of the counterparty risk that it contributes to the transaction, mitigating factors temper some of ENW and BPA's exposure. They include the narrow window that extends only to May 31, 2013, during which time USEC must fulfill its production and supply obligations. Also, take-and-pay contract provisions tie ENW's payment obligations to USEC's delivery of fuel. The supply contract between USEC and ENW provides that the contract will survive a Chapter 11 filing, but can be terminated for bankruptcy filings under other bankruptcy code provisions. If USEC cannot perform and ENW does not have purchase obligations, we understand that ENW can redeem the bonds using unexpended proceeds. However, redemptions are subject to the costs of the bonds' make-whole provisions.

Outlook

The stable outlook reflects our view that Bonneville's stand-alone credit profile can withstand a further downgrade on the U.S. Also, the nearly 8% rate increases established in BPA's rate proceeding covering the two fiscal years that began in October 2011 will help address recent years' erosion of debt service coverage and liquidity due to weak hydrology conditions and soft wholesale power markets. If during our two-year outlook horizon, BPA continues producing cash-basis coverage of federal and nonfederal obligations below 1x, as it did in 2009 and 2010, and its robust liquidity cushion continues eroding, we could lower Bonneville's stand-alone credit profile. Also, if BPA adds significant off-balance-sheet leverage obligations because of its statutory debt ceiling, it could lead to negative implications for the stand-alone credit profile and the 'AA-' rating.

BPA Overview

Bonneville markets electricity generated at 31 federal hydroelectric projects; ENW's nonfederal nuclear CGS; and several nonfederal small power plants. It also operates an extensive transmission system that facilitates power marketing activities. Its transmission system represents about 75% of the Pacific Northwest's transmission capacity.

The 'AA-' ratings on BPA's nonfederal debt reflect the application of our government-related entities criteria (GRE). We believe that Bonneville's stand-alone credit profile is 'aa-' and there is a "moderately high" likelihood that the U.S. government would provide extraordinary support to it in financial distress. We base the latter view on our opinion of the "strong" link between the BPA and the federal government, as well as the "important" federal role the agency plays in the Pacific Northwest. However, after downgrading the U.S. to 'AA+' from 'AAA' in August 2011, we no longer view the U.S. government's sovereign credit profile as lifting the ratings of BPA nonfederal obligations above its stand-alone credit profile.

The GRE rating reflects our view of:

- Bonneville's status as a federal agency;
- The ongoing financial support the federal government provides to the agency through long-term loans and credit lines;
- Legislation that allows BPA to defer repayments of federal obligations if in financial distress; and
- The utility's important contributions to the Pacific Northwest's economy, where it indirectly serves about 12 million electric customers in seven states, provides low-cost power that is critical to the region's economic health, and operates key transmission resources.

Bonneville's stand-alone credit profile reflects our assessment of the following factors:

- The ongoing support the federal government provides to BPA through loans and credit lines;
- The 2009 increase from Congress to the agency's federal borrowing authority to \$7.70 billion, up \$3.25 billion (or 73%). However, Bonneville projects that by 2016 it will consume the headroom between its \$2.9 billion of U.S. Treasury borrowings and \$7.7 billion as it proceeds with its capital program. The \$7.7 billion limit includes \$750 million carved out as a credit line, leaving \$4 billion of capacity;
- The legislative mechanism that allows BPA to pay nonfederal debt as an operating expense ahead of federal debt service and to defer repaying federal obligations if it lacks the financial resources to meet all of its operating and debt obligations;
- A track record of at least 1.8x nonfederal debt service coverage in fiscal years 2007-2011;
- The utility's exceptionally broad and diverse service territory;
- The strong, efficient, and economical operations of the federal hydroelectric Columbia River Power System, which foster strong demand for their output and ENW nuclear production;
- Robust liquidity, which tempers the impacts of variable hydrology conditions on financial performance and mitigates credit risks inherent in biennial rate cases;
- Contracts between BPA and its customers that extend from 2008-2028, which demonstrate the customer base's commitment to the agency's system. However, the new contracts do not establish rates and the utility continues to rely on rate proceedings; and
- Tiered rates that underlie the customer contracts and help shield BPA from market volatility by assigning to customers the costs of energy needs exceeding individual allotments of capacity from the federal hydroelectric

projects and CGS.

Standard & Poor's also incorporates the following exposures in its assessment:

- Financial performance hinges on hydrology conditions that can impair surplus power sales revenues and can require replacement power purchases that add to expenses. Due to poor hydrology, accrual-basis debt service coverage of nonfederal and federal debt was only 0.8x in 2009 and 2010, and 0.9x on a cash basis. BPA's cash from operations was \$268 million in 2009 and \$370 million in 2010, representing the lowest points in cash from operations since 2007's \$872 million. However, we believe robust liquidity provided a cushion that tempered the financial implications of weak hydrology.
- Highly politicized and protracted biennial rate proceedings can delay rate relief and constrain the benefits of autonomous ratemaking authority and financial flexibility. BPA implemented current rates in October 2011 for fiscal years 2012-2013.
- Weak prices in competitive wholesale power markets have persisted since 2009 and compromise revenues from surplus energy sales and financial performance.
- Bonneville and ENW project substantial capital needs that could add to both organizations' debt and consume BPA's Treasury borrowing authority. Bonneville reports it is exploring off-balance-sheet financing arrangements, including leases and energy prepayments by its customers to address expectations that it will soon exhaust its federal borrowing capacity.
- High spring season water flows displace the region's wind generation resources. BPA's commitment to reimburse generators for related losses of production tax credits and renewable energy credits could add costs that it will not address until its next rate proceeding covering fiscal years 2014-2015.

The agency's federal debt includes bonds issued to the U.S. Treasury and federal appropriations that Bonneville must repay with interest. The nearly 1-to-1 ratio of nonfederal-to-federal debt facilitates what we consider sound debt service coverage of the nonfederal bonds as long as rates meet all financial obligations.

Nuclear Fuel Prepay Structure

Series 2012-E proceeds will finance ENW's purchases of nuclear fuel that USEC processes. USEC leases a Department of Energy enrichment facility in Kentucky, where it will produce fuel for sale to ENW through May 31, 2013. The utility's purchase obligations hinge on its obtaining financing.

ENW will retain only a fraction of the fuel to produce electricity at CGS and will sell the balance to TVA to produce electricity and tritium at its nuclear reactors. ENW plans to apply TVA's \$731 million of payments to the 2012-E bonds' debt service. Payments from BPA under the net billing agreements between BPA and ENW will cover the balance of the debt service.

Significantly, other than nominal delivery costs, DOE will provide the fuel's uranium inputs without cost, which should create savings. USEC has contracted to produce and sell to ENW 482 metric tons of enriched product and 4 million SWUs of uranium before June 2013. Inasmuch as Bonneville supports CGS's financial obligations and TVA will purchase 90% (435.5 metric tons) of the enriched product containing 72.5% (2.9 million units) of the SWU that ENW is financing, it is our view that ENW is acting as a financing conduit for BPA and TVA. Sales to TVA will continue through 2022. ENW projects that the 2012-E bonds' tenor will extend through 2027. Consequently, TVA's payments

are not fully aligned with the bonds' debt service and maturities.

Some provisions of the agreement covering ENW fuel sales to TVA present credit concerns, including provisions that allow TVA to defer deliveries and payments within two-year windows tied to BPA's rate case cycle. Deferrals might have negative cash-flow implications for Bonneville and the ENW debt. Also, the agreement allows either TVA or ENW to terminate the agreement if "the other party fails to perform any of its material obligations." We believe that the undefined parameters of materiality could lead to disputes between the parties if either cites material events as a basis for contract termination, which could hamper cash flows from TVA.

We view this structure as adding leverage and counterparty risk to BPA's stand-alone credit profile. Moreover, while we understand that this financing structure does not consume headroom available to either Bonneville or TVA under their debt ceilings, we view ENW's nuclear fuel financing on behalf of TVA and BPA as creating off-balance-sheet leverage for these utilities that could cause negative implications for their stand-alone credit profiles if the utilities meaningfully increase their use of off-balance-sheet financing structures.

Bonneville's Nonfederal Debt Obligations

BPA's nonfederal rated obligations include:

- \$5.2 billion of ENW revenue and refunding bonds;
- \$116.7 million of Public Utility District No. 1 of Lewis County, Wash., Cowlitz Falls Project bonds;
- \$119.6 million of Northwest Infrastructure Financing Corp. (Schultz-Wautoma project) bonds;
- \$21.7 million of Northern Wasco Public Utility District, Ore. (McNary Dam Project) bonds;
- \$11.2 million of conservation and renewable energy system bonds; and
- \$6.7 million of Tacoma, Wash., conservation system project bonds.

Through the Northwest Infrastructure Financing Corp., which developed transmission assets financed through lease arrangements, Bonneville also has \$566 million of line of credit obligations.

Related Criteria And Research

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Electric Utility Ratings, June 15, 2007

Ratings Detail (As Of August 1, 2012)

Energy Northwest, Washington

Bonneville Pwr Admin, Oregon

Energy Northwest elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating Sta, & proj 3 elec rfdg

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest proj 1, Columbia Generating St, & proj 3 elec rev rfdg bnds (Bonneville Pwr Admin) ser 2006 A-D

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Energy Northwest (Bonneville Pwr Admin) elec rev rfdg bnds (Bonneville Pwr Admin) (Project 1 Taxable) ser 2012-C due

Ratings Detail (As Of August 1, 2012) (cont.)

07/01/2015

<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) elec rev rfdg bnds (Bonneville Pwr Admin) (Project 1) ser 2012-B due 07/01/2017		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) proj 3 elec rev rfdg bnds var rate subseries F-1 (Bonneville Pwr Admin) ser 2008-F dtd 06/17/2008 due 07/01/20		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) rfdg rev bnds (Bonneville Pwr Admin-Nuclear Proj #1 & #3) ser 1993C dtd 09/01/1993 due 07/01/1996 1999 2002-20		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) Sub Lien		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (MBIA) (AGM)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (Nuclear Proj 1,2,3)		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Bonneville Pwr Admin elec rev rfdg bnds ser 2005 A & taxable ser B dtd 05/26/2005 due 07/01/2008 2013-2018		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Bonneville Pwr Admin elec rev rfdg (Colu)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest rfdg elec rev bnds (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Energy Northwest (Bonneville Pwr Admin) (XL Capital Assurance Inc.)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Washington Pub Pwr Supp Sys (Nuclear Proj #3) rfdg rev bnds ser 93C dtd 9/23/93 due 7/1/2013 2014 2015 2017(CUSIP #939830RW7 RY3 RX5 RZ0)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Washington Pub Pwr Supp Sys (Nuclear Proj #3) (Bonneville Pwr Admin)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Lewis Cnty Pub Util Dist #1, Washington		
Bonneville Pwr Admin, Oregon		
Lewis Cnty rev rfdg bnds (Bonneville Pwr Admin) (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2007-2012		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Lewis Cnty (Bonneville Pwr Admin) rev rfdg bnds (Cowlitz Falls Hydroelectric Proj) ser 2003 dtd 07/16/2003 due 10/01/2013-2024		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Ratings Detail (As Of August 1, 2012) (cont.)

Northern Wasco Cnty Peoples Util Dist, Oregon

Bonneville Pwr Admin, Oregon

Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) rev rfdg bnds (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj) ser 2012A due 1

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Northern Wasco Cnty Peoples Util Dist (Bonneville Pwr Admin) (McNary Dam Fishway Hydroelec Proj)

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Northwest Infrastructure Financing Corp., New York

Bonneville Pwr Admin, Oregon

Northwest Infrastructure Financing Corp. (Bonneville Pwr Admin) TRANS

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Tacoma, Washington

Bonneville Pwr Admin, Oregon

Tacoma (Bonneville Pwr Admin) (Pub Util Lt Div Conserv Sys Proj)

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Many issues are enhanced by bond insurance.

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