

B O N N E V I L L E P O W E R A D M I N I S T R A T I O N

2009 Annual Report



Building
for the future



Providing the Northwest clean, reliable and affordable energy



Table of Contents

BPA Profile	2
Financial Results	3
Letter to the President.	4
The Year in Review	7
Performance Target Results.	28

FINANCIAL SECTION

Forward-Looking Information	33
Management’s Discussion & Analysis	36
Financial Statements	46
Notes to Financial Statements.	51
Report of Independent Auditors.	75
Federal Repayment	76
BPA Executives	79
BPA Offices	80

BPA Profile

2

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 owned and operated by the U.S. Army Corps of Engineers and Bureau of Reclamation, one nonfederal nuclear plant owned and operated by a consortium of utilities, and several other small nonfederal power plants. BPA also operates and maintains about three-fourths of the region's high-voltage transmission. About one-third of the electric power used in the Northwest comes from BPA.

BPA is a self-funding agency that covers its costs by selling or exchanging wholesale power and related services at cost to meet the needs of consumer-owned utilities and investor-owned utilities in the region. BPA also sells or exchanges power with some large industries in the region and with marketers and utilities in Canada and the western United States. Its service area includes Oregon, Washington, Idaho, western Montana, and small parts of Wyoming, Nevada, Utah, California and eastern Montana.

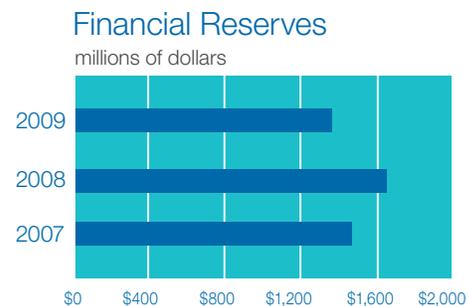
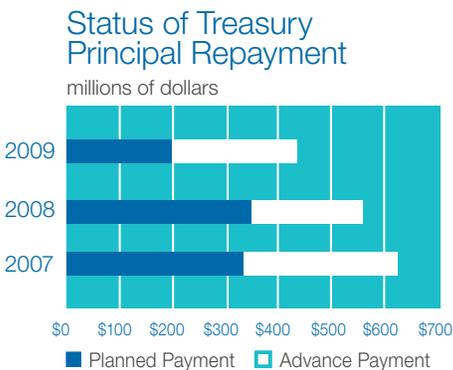
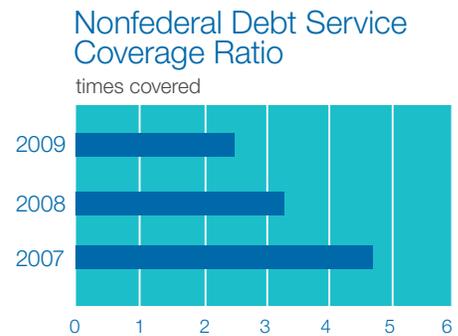
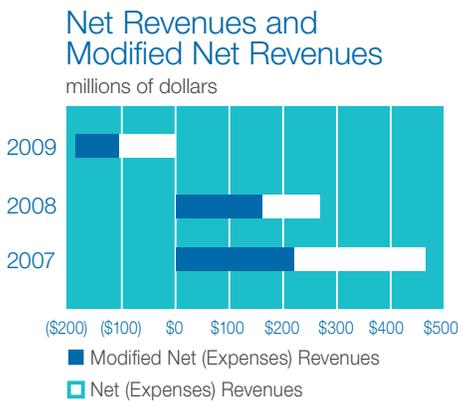
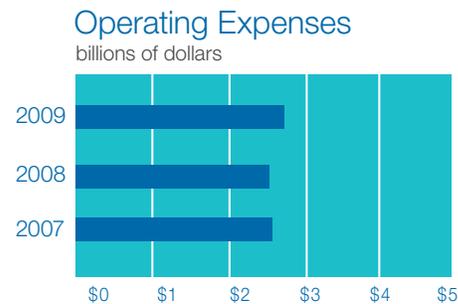
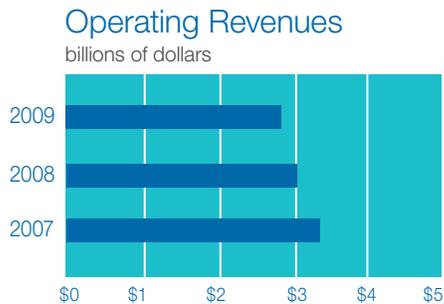
BPA promotes energy efficiency, renewable energy and new technologies. The agency funds regional efforts to protect and enhance fish and wildlife populations affected by federal hydropower development in the Columbia River Basin.

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

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



Financial Results



These charts depict important BPA and Federal Columbia River Power System financial measures. **Net Revenues**, after removing the effects of nonfederal debt management actions that differ from rate case assumptions and derivative instruments, result in **Modified Net Revenues**. **Nonfederal Debt Service Coverage Ratio** demonstrates how many times total nonfederal project debt service is covered by net funds available. A ratio of 1.0 is the minimum required to show adequate funds to meet debt service payments to nonfederal bondholders. The **Status of Treasury Principal Repayment** shows the planned and advance payment of federal appropriations and borrowings from the U.S. Treasury. **Financial Reserves** are the sum of BPA cash, investments in market-based specials and deferred borrowing authority at year-end.

Letter to the President

Dear Mr. President:

As with almost every institution and business, the Bonneville Power Administration has not escaped the nation's and region's economic woes. We have seen a significant drop in our revenues compared to previous years. Despite the economy, however, BPA retained its fundamental strength and stability, as evidenced by upgrades in bond ratings and by fully meeting our annual payment to the U.S. Treasury.

Despite a tough year financially, fiscal year 2009 was a year of notable achievements, all connected by a common theme – building for the future. Among those achievements, the following in particular stand out.

Last December, we signed long-term wholesale power sales contracts running through fiscal year 2028 with all of our preference customers (consumer-owned utilities). These contracts have a number of benefits. Because of their duration, they help provide regional stability by keeping the low-cost power benefits of the federal system in the Northwest for the longer term. They include tiered rates that incent building the infrastructure that will be needed to support the region's economy in the future. They also promote energy efficiency and renewable resources.

It was also the year that wind power came of age in the Pacific Northwest. In fiscal year 2009, we increased the amount of wind integrated into our transmission system from 1,500 megawatts to more than 2,200 megawatts, a figure we expect to double by fiscal year 2012. Integrating wind

brought technical challenges, but we are meeting those challenges aggressively with innovative solutions and are excited by the opportunity to increase the nation's store of emission-free renewable resources for future generations.

Once again, we also exceeded our conservation targets for the year, capturing more than 70 average megawatts of energy efficiency. This coming year, we are planning to meet the most aggressive megawatt target yet set in the region. In its draft power plan, the Northwest Power and Conservation Council, a regional energy policy entity, is calling for 1,200 average megawatts of conservation savings (enough to power a city the size of Seattle) in 2010-2014. This is equal to all of the conservation savings BPA has acquired in the last 25 years. BPA and its customers are committed to acquiring the public power share of that target. This, too, is an important step toward a better future.



During the year, we also broke ground on a new 500-kilovolt transmission line, the McNary-John Day project, and began preparation for environmental reviews on three more transmission projects. Not only will new transmission lines facilitate the delivery of wind energy and other renewable energy resources to population centers and shore up transmission grid reliability, but they also will provide construction jobs.

This timely construction of new transmission was facilitated by the administration's economic stimulus package. As part of the American Recovery and Reinvestment Act, Congress increased BPA's available borrowing authority from the U.S. Treasury by \$3.25 billion. It gave us the confidence to move forward with a much needed construction program. Without this additional increment, we could have exhausted our remaining borrowing authority as early as 2013.

As for future projects, using a transparent process launched in 2008, we developed capital budgets that will come close to doubling our capital expenditures. In addition to transmission, the funding will be directed to new renewable resources, hydropower enhancements, energy efficiency and fish and wildlife projects – all of which support a future with a reduced carbon footprint.

Finally, we were gratified that the administration supported the regionally developed plan, called a biological opinion, that addresses endangered salmon and steelhead runs in the Columbia River Basin. Thanks to an extensive science-based review, backed up

with an implementation plan that will provide a safety net if fish runs begin a severe decline, your administration concluded that the biological opinion is legally and biologically sound and is based on the best available science. We believe this is a hugely important step in moving the region away from courtroom litigation and forward on collaboratively implementing the measures that will help the region's fish runs continue to rebound.

These initiatives are occurring at a time when the Pacific Northwest power system is fundamentally changing. Historically, ours was a winter peaking system for energy demand, but we are now experiencing dual summer and winter peaks. We are exploring ways to better coordinate within the West-wide grid. We are enabling the addition of large amounts of wind to the region's hydro system and revamping our transmission operation to accommodate this variable generation.

These events make this a time of great challenge and opportunity for BPA and the energy industry in the Northwest. In partnership with Northwest utilities, federal and state agencies, Northwest tribes and other stakeholders, we are all working to build a stable and productive future for the Pacific Northwest and for our nation.



Stephen J. Wright
BPA Administrator and CEO

Note: Unless otherwise noted, all annual dates in this report refer to the federal fiscal year, which begins Oct. 1 and runs through Sept. 30. For example, fiscal year 2009 began Oct. 1, 2008, and concluded Sept. 30, 2009.



6

Providing Certainty

Our new long-term power sales contracts will provide stability, promote adequate infrastructure and encourage conservation.

The Year in Review

This fiscal year 2009 report covers a wide range of complex and engaging issues. The Bonneville Power Administration plays an integral role in the Pacific Northwest's economy and its environment. Our vision calls for us to be an engine of the region's economic prosperity and sustainability.

We are also part of the U.S. infrastructure system and share the nation's goals of developing emission-free resources and energy independence. The initiatives and projects described in the following pages illustrate the ways we are working to achieve this vision and building for the future.

Finance

Water is always a key underpinning of the Bonneville Power Administration's financial performance. Ours is a hydro-based system with more than 82 percent of our firm power provided by the region's federal dams. During 2009, the January-July hydro runoff came in at 90 million acre-feet, 84 percent of the rolling 30-year average, which is 107 million acre-feet.

Year-end financial results

In some low-water years, market power prices remain high because of a general supply shortage. That was not the case this year because of the downturn in the regional and national economies. The low economic activity reduced the demand for natural gas, which in turn drove down the market price for electricity. The two prices are linked because many of the West's power plants that sell electricity in the competitive market are fueled by natural gas.

As a result, our modified net revenues for the year were the lowest they have been since the energy crisis of 2000-2001. Nevertheless, despite the financial results, BPA showed solid strength in the fundamentals that position us for the future. We made our annual 2009 Treasury payment on time and in full and met all other debt obligations. And because of solid financial performance since the West Coast energy crisis, BPA ended the year with \$1.4 billion in financial reserves.

For the reasons described above, financial results for 2009 did not meet agency targets, with Power Services coming in well below its target. The bright spot was Transmission Services, which had net revenues exceeding its targets for the fourth year in a row.

Overall agency net expenses for 2009 were \$101 million on total operating revenues of \$2.9 billion, compared to net revenues of \$265 million for the previous year on total operating revenues of \$3.0 billion.

Adjusted for debt management actions and fluctuations in derivative instruments market prices, BPA's modified net expenses were \$187 million, compared to modified net revenues of \$157 million in 2008.

Bond rating upgrade

Our underlying economic strength was affirmed when two credit rating agencies upgraded bonds backed by BPA credit. Fitch Ratings upgraded BPA-backed Energy Northwest (nuclear plant) bonds from AA- with a positive outlook to AA with a positive outlook. Standard & Poor's rating service upgraded the same Energy Northwest bonds, along with a smaller amount of other nonfederal BPA-backed bonds, from AA- with a stable outlook to AA with a stable outlook. The third rating agency, Moody's, kept its rating at Aaa, the highest possible rating.

Among the reasons given for the upgrades are the long-term (through fiscal year 2028) power sales contracts BPA signed with all of its preference customers (consumer-owned utilities), the agency's recently increased borrowing authority and the agency's high level of reserves.

Economic stimulus legislation

BPA was included in the American Recovery and Reinvestment Act in a unique way. The legislation authorized a \$3.25 billion increase in BPA's borrowing authority limit through the amount of bonds that BPA may have outstanding under the Federal

Columbia River Transmission System Act. BPA will repay the U.S. Treasury, with interest, for each dollar it borrows.

This increase provided certainty, at least in the near term, for how we will fund our capital investment program. The increased borrowing authority enabled us to begin construction this past summer on the McNary-John Day transmission line, a year earlier than originally planned. It also provided the financial certainty that makes it possible for us to begin environmental work on three additional proposed transmission projects.

Without the additional increment from the Recovery Act, we could have reached our Treasury borrowing authority limit as early as 2013. With this addition to our borrowing authority limit, the expected date has been moved out to 2018.

We are currently identifying projects that address system needs and fit Recovery Act criteria. Projects under consideration fall into these general categories:

- Transmission and hydro projects needed to maintain the quality and reliability of the Northwest power system and projects that would optimize the output of this significant source of non-carbon-emitting electrical generation while facilitating new renewable generation.
- Fish and wildlife projects to support restoration of salmon and steelhead listed for protection under the Endangered Species Act.

- Assistance with regional programs to meet clean energy goals through capitalization of major investments in energy efficiency.

Some Recovery Act funding will benefit BPA headquarters. The General Services Administration, which owns BPA's headquarters building, is greening the building with a \$4.5 million project funded through the Recovery Act. BPA headquarters incorporated state-of-the-art energy efficiency features when it was built in the 1980s, but the field has advanced so much in the last 20 years that there are now substantial further greening opportunities within its walls.

2010-2011 BPA rate case

For the first time since 2002, it was necessary to raise our wholesale power rates. Fortunately, we were ultimately successful in keeping the increase to just under 7 percent. Thanks to a partial settlement with transmission customers, we were able to extend existing transmission rates with no rate increase. The new rate period, which went into effect Oct. 1, 2009, covers fiscal years 2010-2011.

Our initial power rate proposal in February called for an average 9.4 percent increase. Projections of poor net revenues due to the combination of low water and low market power prices put upward pressure on rates. Additional pressures came from increased operation, maintenance and

capital costs to improve reliability and safe operation of the Columbia Generating Station nuclear plant; increased capital and operating costs of the hydro system to maintain and improve reliability and output; and new biological opinion requirements for endangered fish and implementation of the Columbia Basin Fish Accords.

As the year progressed, the January-July water runoff continued to drop below average, and secondary (surplus) sales fell below expectations. BPA Power Services was concerned that the power rate increase could move well into double digits. Fortunately, several factors combined to bring the increase down. These factors included a concerted internal cost reduction and deferral effort;



program reductions arrived at collaboratively in a public process known as the Integrated Program Review, as well as other venues; and the additional liquidity gained through a U.S. Treasury agreement to increase BPA's short-term line of credit.

Transparent business practices

In 2008, we held our first Integrated Program Review of Power Services and Transmission Services costs. The review allowed interested parties to comment on all of BPA's forecast expense and capital spending level estimates prior to setting rates. Our goal is to have a complete review of planned program costs for both power and transmission before an initial rate case proposal.

However, because of the deteriorating economy and secondary power sales, BPA held a second Integrated Program Review during 2009 coinciding with the rate case to further address planned spending levels. In this second collaborative process, we identified more than \$100 million in forecast Power Services cost reductions over what

had been proposed for the fiscal year 2010-2011 rate period.

Increased financial rigor

Early in the fiscal year, BPA staff was directed to search out cost-saving opportunities and to approach spending decisions conservatively as the nation and region faced deteriorating economic conditions. This was followed in spring by an agencywide cost cutting effort and project reprioritization to minimize rate increases and to assure timely completion of the highest priority projects.

We have continued to maintain rigor and control in our investment decision making by prioritizing capital projects and by separating funding decisions from project approval. The capital asset approval process applies a standard approach to presenting projects for decision making and assures a consistent, disciplined review. We continued work on clear, transparent and well-documented asset management plans, establishing policies for long-term investments and system maintenance.

Power Services

Power Services successfully addressed a number of complex issues in 2009. These included the consequences of past court decisions, a new rate case, the long-term

future through the new long-term wholesale power sales contracts and the details and processes associated with implementing those contracts.



Planning for resources

We are planning to assure adequate power resources and transmission infrastructure for our customers.

Long-term power sales contracts

BPA reached a historic milestone in December 2008 when we signed long-term wholesale power contracts with all 135 preference customers and with most of our investor-owned utility customers. The contracts had been under discussion since at least 2002 in a process known as the Regional Dialogue.

Power sales under these contracts will begin in fiscal year 2012, when most current contracts expire, and will run through fiscal year 2028. The contracts offer multiple benefits. Because of their duration, they help provide regional stability by keeping the low-cost power benefits of the federal system in the Northwest for the longer term. They provide certainty to customers about their long-term access to low-cost federal power, and they provide BPA with a guaranteed source of revenue that will ensure it can cover its costs in the long term, including annual Treasury payments.

Because the contracts are paired with a new tiered rates structure, they will send appropriate price signals to encourage investments in future electricity infrastructure in the Pacific Northwest, thus helping ensure resource adequacy. In addition, the contracts promote continued emphasis on conservation and development of carbon-free resources.

Implementation issues

Signing contracts did not end the work on the Regional Dialogue. Implementation issues will be a focus between now and October 2011, when sales and delivery of power begin.

We adopted a tiered rates methodology before the contracts were signed so that our customers would understand how rates would be determined under the contracts. Under tiered rates, preference customers will pay Tier 1 rates for power produced by the existing federal system, with limited augmentation.

As our loads grow beyond what the system can produce, customers have a choice to secure nonfederal power on their own or to purchase the additional power through BPA. Tiering rates will eliminate the historical economic incentive to place all load growth on BPA due to the practice of melding the low-cost existing hydro system with new and more expensive generating resources.

We worked on other implementation issues, including how each customer's right to buy power from the federal system at Tier 1 rates would be determined. We also conducted public processes to clarify how we intend to administer the Residential Exchange Program.

The purpose of the Residential Exchange Program is to give Northwest residential and small-farm consumers a share in

the benefits of low-cost federal power, whether they are served by consumer- or investor-owned utilities. Exchange benefits provided by BPA must be passed on to those residential and small-farm consumers of the participating utilities that qualify for the exchange.

Resource planning

We intend to assure we can meet our preference customers' future needs if they choose to buy additional power from us to serve their load growth. They have until November 2009 to determine how much power they intend to buy from BPA starting in October 2011.

We spent much of 2009 preparing a draft Resource Program, released in September 2009. The draft program indicates that through 2019 we likely can meet most or all of our customers' needs for BPA power by achieving the Northwest Power and Conservation Council's conservation targets and continuing to make purchases in the wholesale power market.

Beyond these actions, whether and how much additional power BPA might need over the next decade will depend on a number of uncertainties, including climate change policies, timing and strength of economic recovery, success of our wind integration and energy efficiency initiatives, fish requirements and others.

To address these uncertainties, the draft Resource Program suggests BPA increase transmission flexibility for intermittent renewable resources, support development

of cost-effective small-scale renewable and cogeneration resources and explore the potential availability of pumped hydropower storage and, possibly, natural gas-fired resources.

Once finalized, the Resource Program will serve as the roadmap for prioritizing BPA's resource-related actions. Any eventual resource acquisitions will be consistent with the Northwest Power and Conservation Council's regional resource plan.

International relations

Since 1964, the Columbia River Treaty has provided significant benefits to the United States and Canada through coordinated river management by the two countries. The treaty provides for a U.S. Entity to carry out U.S. obligations under the treaty. BPA and the U.S. Army Corps of Engineers are the two agencies that implement the treaty in the United States on behalf of the U.S. Entity.

During fiscal year 2009, BPA oversaw the delivery to the U.S.-Canadian border of 4.1 gigawatt-hours, in amounts up to 1,326 megawatts on any hour, as pre-scheduled by Canada.

Although the purposes of the treaty are flood control and maximizing power generation, we were able to negotiate a supplemental operation agreement with Canada under the treaty to provide up to 1 million acre-feet of additional spring and summer flow and other benefits to fish.



14

Building the infrastructure

Our new transmission projects will increase reliability and deliver renewable resources to population centers.

Transmission Services

The Northwest's growing population and priority for clean renewable energy are placing new demands on BPA's transmission grid. One thing is clear – additional transmission is needed. Wind development in particular is changing how the transmission system is operated.

New construction

The \$3.25 billion expansion of BPA's available borrowing authority included in the American Recovery and Reinvestment Act is giving the agency the financial certainty to support the most extensive improvements in the Northwest transmission system in decades. In early summer, we broke ground on the 79-mile McNary-John Day 500-kilovolt project. Not only will this project create construction jobs, but regional firms are building the primary part of the project and providing many of the materials.

Most importantly, when energized in early 2012, the McNary-John Day line will allow BPA to provide transmission service to more than 625 megawatts of additional energy, including service for more than 575 megawatts of new wind energy.

With the McNary-John Day line under construction, BPA is preparing an environmental review of three other key transmission projects as expeditiously as possible. These include the Big Eddy-Knight

and Central Ferry-Lower Monumental projects and the I-5 Corridor Reinforcement.

Together, these four projects would add more than 225 miles of lines to the Northwest transmission grid, improving reliability and, together with a related smaller line upgrade, allowing BPA to provide transmission service to large amounts of wind power and other renewable energy resources.

Conclusion of Network Open Season

The McNary-John Day project is the first project to break ground as a result of BPA's new Network Open Season process. The Network Open Season process is designed to better manage numerous transmission requests and to set priorities for financing and building transmission projects. The first Network Open Season was initiated in fiscal year 2008 and completed in this fiscal year.

It resulted in 6,410 megawatts of transmission requests for which customers committed to take service. Because Network Open Season and the subsequent studies better clarified transmission interactions, we were able to accommodate more than 20 percent of those requests with existing transmission.

We also defined and completed financial analysis of nine transmission projects. This allowed us to propose transmission projects that would provide transmission for 85 percent of the total requests with only an estimated 2 percent impact on transmission rates over 20 years.

Second Network Open Season

BPA conducted a second Network Open Season last spring. By the August deadline, 16 customers had signed precedent transmission service agreements with us for 1,553 megawatts of transmission service. Approximately 60 percent of the requested service is for wind generation. BPA is conducting a study to determine the available transmission capability we can use to offer service immediately. Next, we will conduct a cluster study to determine whether additional system upgrades or new lines are needed to provide service for the remaining requests.

In a related action, in August, the Federal Energy Regulatory Commission issued a declaratory order approving our 2009 Network Open Season process.

Conditional firm product

As a result of concluding the first round of the Network Open Season and making some key changes to our automation systems, we began offering a conditional firm transmission product to utilities in the transmission queue.

As the name suggests, the conditional firm product is a transmission service that is subject to additional curtailment under certain conditions. When BPA cannot meet a customer's entire request for firm transmission because of a lack of available transfer capability, the conditional firm product offers less-than-firm transmission service through a curtailment priority in a defined number of hours a year.

Conditional firm transmission service leverages existing resources and is a nonwires solution for the region and the nation. Following the 2008 Network Open Season, BPA made about 1,200 megawatts of conditional firm transmission available without building any new lines. Additional conditional firm capability remains on some flowgates for use in the future.

Renewable Resources

Wind power has grown more quickly in the Pacific Northwest than anyone expected. An Aug. 6 milestone exemplifies wind's rapid growth. On that date, for the first time, BPA's transmission grid carried more than

2,000 megawatts of wind power for more than an hour, doubling the peak of 1,000 megawatts recorded in January 2008. This is enough energy to power two cities the size of Seattle, Wash., for that hour.



An aggressive approach to integrating wind will allow BPA to continue to enable development of large amounts of wind energy in a reliable, cost-effective manner.

Integrating wind into the grid

Most Northwest wind power is connected to BPA's transmission grid, primarily east of the Columbia River Gorge. BPA has built five substations and six taplines to tie wind farms into its transmission grid with more under construction. Wind power in our balancing authority has nearly doubled in each of the last four years. We expect to host up to 6,000 megawatts of wind power by 2013.

In June, we committed to an 18-month schedule for completing five highly technical projects to manage large amounts of wind power in the transmission grid. These Wind Integration Team projects will support continued fast growth of wind resources. Wind development also is fundamentally changing the way we operate our

transmission system. Because wind is a variable resource and often unpredictable, our system must be able to respond faster and more flexibly to accommodate it.

Key projects include moving from scheduling power by the hour to allowing schedule changes within each hour and developing the ability for wind projects to supply their own reserves. Other projects include new reliability protocols that will curtail wind generators if BPA has consumed 90 percent of reserves and joint utility initiatives to improve grid flexibility across multiple balancing authorities. BPA also has installed 14 anemometers for a wind forecasting system to help schedulers more accurately predict wind generation and thereby safely reduce balancing reserves.

We also have joined with other utilities in requesting vendor proposals for a common dynamic scheduling system. We are working with utilities from across the West on a Joint Initiative to pursue a common Open Access Same-time Information System.

We believe that, with these actions, we can move from a system that has 20 percent wind to peak-load to a system approaching a 40 percent wind to peak-load over the next two years.

Wind integration rate

Wind power delivered through BPA's transmission system serves consumers throughout the Northwest and in California. Our 2010-2011 transmission rates

established this year include an integration rate charged to wind power generators of \$1.29 per kilowatt per month or about \$5.70 per megawatt-hour. This rate recovers costs of providing reserves to balance sudden, unscheduled changes in wind power output. The rate is less than half that proposed in BPA's initial proposal, thanks largely to actions agreed to by wind generators to improve the accuracy of their generation scheduling.

18 Energy Efficiency

This year, we began gearing up to significantly increase our energy efficiency achievements in years to come. While efficiency already meets 12 percent of the Northwest's electricity needs, the Northwest Power and Conservation Council's draft Sixth Power Plan calls for tripling energy efficiency achievements in the next decade.

Conservation success

We exceeded our conservation targets for the year. In 2009, we captured more than 70 average megawatts of energy efficiency. Over the year, our energy efficiency team garnered a number of awards, including two Energy Management Awards from the Department of Energy. These awards are presented each year to outstanding individuals, small groups and organizations in the field of energy and water management at federal facilities.

BPA's Federal Agency Energy Efficiency Program also won two awards: an Outstanding Small Group award for its BPA-Navy initiative team and an Outstanding Organization award for the program's overall achievements in fiscal year 2008.

New aggressive efficiency targets

This coming year, we are planning to meet the most aggressive megawatt targets yet set in the region. Under the Council's draft power plan, the region should achieve 1,200 average megawatts of conservation savings in 2010-2014 from utility programs, market transformation efforts and new codes and standards. While the draft plan calls for nearly 6,000 average megawatts of cost-effective conservation over 20 years, it recognizes about 2,500 average megawatts will require



Acquiring energy efficiency

In collaboration with our customers, we are setting ambitious targets to acquire new conservation.

new initiatives. The five-year action plan calls for regional collaboration to develop and deploy these measures.

We support the aggressive pursuit of energy efficiency and are committed to joining with regional consumer-owned utilities to achieve public power's share of the Council's energy efficiency targets. We are now working with our customers and regional interests to achieve these ambitious targets consistent with the new long-term power sales contracts. We also endorse the Council's proposal to have a "check in" period after a few years of implementation to make sure we're aligned on the pace and approach.

The Council was encouraged to accelerate the region's efficiency efforts by the results of a year-long collaborative Northwest Energy Efficiency Taskforce co-sponsored by BPA, the Council and PacifiCorp, an investor-owned utility. BPA has anticipated the need to accelerate energy efficiency acquisitions.

Tribal efficiency program

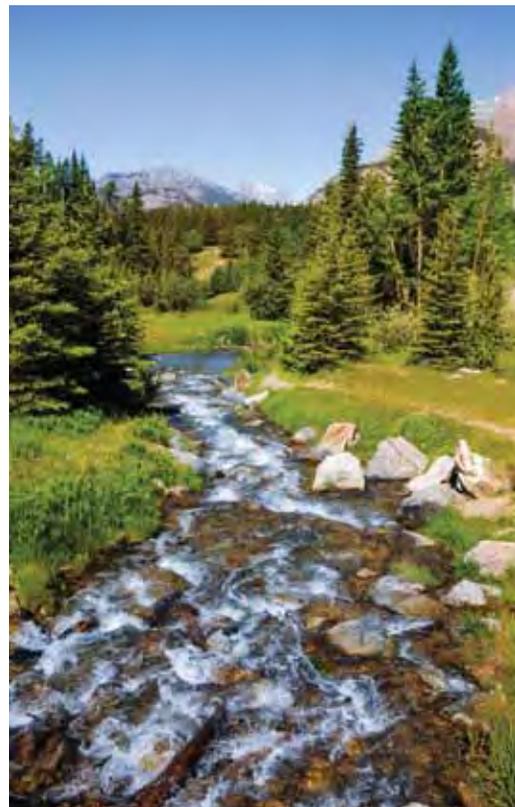
In a first in the nation, every light bulb on the Burns Paiute reservation in Oregon is now a compact fluorescent bulb. It took tribal members about three weeks to effect the 1,200-bulb transformation funded by BPA. The reservation houses about 175 members in 60 homes.

The Burns Paiute experience exemplifies the Northwest's energy efficiency

commitment. BPA and the region have been tremendously successful in providing power resources in the form of energy efficiency.

Energy efficiency at BPA

This year, we retrofitted lighting in 28 buildings at our Ross Complex in Vancouver, Wash., reducing lighting load 57 percent. In addition to matching our own energy efficiency goals, this project is part of the agency's response to Executive Order 13423, which requires federal agencies to improve energy efficiency.



Fish and Wildlife

As part of our mitigation for the effects of hydropower construction and operation, BPA funds extensive programs and projects to rebuild endangered fish runs and enhance the health of other fish and wildlife in the Columbia Basin. This effort represents one of the largest environmental efforts in the nation. This year, Northwest salmon and steelhead got a boost when the administration endorsed, with certain enhancements, a regional plan to help endangered fish runs.

Operational changes

In March, the U.S. Army Corps of Engineers installed a surface passage spillway weir at Little Goose Dam, so that all of the four lower Snake River dams now have spillway weirs. The weirs permit juvenile fish to pass near the surface of the water rather than diving some 50 to 60 feet to pass through the typical spillway opening, making a less stressful passage route for the fish.

The new Little Goose weir is essentially the same as spillway weirs on other Snake River dams, except it has a simpler design that substantially reduces its costs. The Little Goose weir was built and installed by Northwest firms, representing a substantial benefit to the region's economy. BPA reimburses the U.S. Treasury for Corps and Bureau of Reclamation appropriations used to fund installation of fish measures at the region's federal dams.

Encouraging returns

Adult returns of salmon and steelhead in 2009 were encouraging, as they have been throughout this decade. The seven top returns of adult chinook at Bonneville Dam all have occurred since 2000.

In a report to Congress, National Oceanic and Atmospheric Administration Fisheries noted that wild fish in five of the seven listed stocks in the mid and upper Columbia and Snake rivers are doing much better than when they were listed in the 1990s. This year's returns of wild and hatchery fish in many of the listed stocks were very positive — steelhead, sockeye and coho returns to Bonneville Dam exceeded 10-year averages. Steelhead returns to Bonneville Dam were the second highest since the dams were built. The largest number of Snake River sockeye since counting began in the 1990s made the 900-mile journey from the ocean to Redfish Lake in Idaho this year.

New Accords signatory

In November 2008, the Shoshone-Bannock Tribes joined the Columbia Basin Fish Accords. Through the Accords, participating tribes and states have committed to achieve specific biological objectives linked to meeting federal agencies' salmon recovery requirements in return



22

Forging collaboration

With a focus on transparency and collaboration, we are building stronger relationships with our stakeholders.

for 10 years of guaranteed funding, principally from BPA. The Accords are an important confirmation of the region's growing support for moving away from litigation to greater collaboration.

BPA, the U.S. Army Corps of Engineers and the Bureau of Reclamation are parties to the Accords, which were first signed by four Columbia River tribes and the states of Idaho and Montana in May 2008.

The Shoshone-Bannock Tribes' signature is noteworthy in that it expands the original Accords' efforts into the Snake River Basin. The funds will go toward habitat restoration and hatchery improvements.

First Accords projects

Construction of the first projects funded under the Accords began this past summer. One of the first was an overhaul of an outdated fish ladder on the Klickitat River in south-central Washington. This project will greatly improve salmon and steelhead access to more than 60 miles of prime spawning habitat. The Yakama Nation, Washington Department of Fish and Wildlife and the U.S. Forest Service co-sponsored this project.

Other projects under way include screening of irrigation diversions, reconnection of important side channels, piping to reduce irrigation conveyance losses, elimination of passage barriers, creation of jump pools to facilitate passage, replacement of push-up dams with lay-flat stanchions and removal of barriers to reconnect floodplain that had been cut off to fish for 80 years.

The Independent Science Review Panel of the Northwest Power and Conservation Council is reviewing all Accords projects to ensure they are based on sound science.

Estuary habitat restoration

The Columbia River estuary is a critical nursery for juvenile salmon on their way to sea. BPA and other federal agencies have increased attention to and funding for the estuary, especially because estuary work benefits all 13 Columbia Basin salmon and steelhead stocks listed under the Endangered Species Act. On Sept. 16, BPA signed a memorandum of agreement committing a total of \$40.5 million through 2018 to a new partnership among BPA, the Corps, Reclamation and the state of Washington for salmon and steelhead habitat restoration in the estuary. The action nearly doubles estuary habitat funds, strengthening the federal commitment to listed stocks.

Development of the estuary habitat agreement with Washington is another example of the collaborative way the federal agencies are working with regional partners to advance fish protection. The Washington Department of Fish and Wildlife will sponsor or coordinate estuary projects, working in concert with other agencies and partners. Each project will undergo scientific review to confirm its benefits to fish. The new memorandum of agreement also uses BPA funding to leverage additional federal funding through a Corps' cost-sharing program for estuary habitat.

Hatchery programs

BPA works with project sponsors to assure that BPA-funded projects are scientifically valid, cost-effective and well managed. A 2009 Department of Energy Inspector General's report on BPA hatchery funding made no formal recommendations for improvement. The Inspector General particularly complimented our new fish and wildlife management systems that actively involve project sponsors in documenting their work and costs online to assure ratepayer funds are invested effectively. We also are participating with other agencies in a comprehensive review of all 186 hatchery programs in the Columbia Basin.

Habitat protection

Mitigation also continues for resident fish and wildlife habitat, as well as salmon and steelhead affected by federal dam construction and reservoir inundation. This year, BPA funded acquisitions and easements totaling 5,365 acres to provide permanent protection for riparian and upland fish and wildlife habitat throughout the Northwest. This habitat, which is managed by state agencies, tribes and conservancies, will provide protection for a number of species including wildlife, salmon, steelhead and resident fish.

We also conducted tests using helicopters equipped with infrared cameras to measure stream temperatures. The data will help identify stretches of the rivers that would benefit from further habitat improvements.

The biological opinion

When a species is listed as endangered, the agency with responsibilities for actions to protect that species will consult with federal agencies on proposed actions. The listing agency must then issue a biological opinion stating whether the proposed actions will jeopardize the continued existence of the listed species or destroy or adversely modify designated critical habitat. In the case of Columbia Basin salmon and steelhead, the National Oceanic and Atmospheric Administration Fisheries is the listing agency.

In May 2008, NOAA Fisheries issued a biological opinion covering federal hydro system operations for protection of endangered salmon and steelhead. This opinion also addressed habitat and hatchery improvements. The biological opinion has been the subject of litigation, and a federal judge is reviewing the opinion to determine if it is adequate under the Endangered Species Act. In early 2009, the judge asked the Obama administration to consider whether the opinion met ESA requirements.

In early September, following an intensive science-based review, the administration announced its conclusion that the opinion, with some added enhancements from the administration, is legally and biologically sound and is based on the best available science.

The administration has added into the biological opinion an aggressive program, called an Adaptive Management

Implementation Plan, that calls for new contingency measures to take if a species begins to decline to levels seen when the fish were listed. These include extensive measurements, enhanced analytical tools,

monitoring and safety net features — all designed to keep improvement of fish runs on track. Breaching of four lower Snake River dams is included in the administration's implementation plan, but only as a last resort.

New Initiatives for the Future

BPA is looking to the future with new initiatives in renewable energy, smart grid, climate change, technological innovation and other efforts that will help bring about cleaner and lower cost energy and greater energy independence. We are working in partnership with other utilities and stakeholders on a number of research, development and demonstration projects, such as the examples below.

Smart grid

BPA has long promoted smart grid technologies both to improve transmission reliability and to reduce the need for new transmission equipment and power resources. In August, we joined 12 utilities and five major technical firms across five states in a regional smart grid demonstration project proposal submitted to the Department of Energy by the Battelle Memorial Institute, Pacific Northwest Division. Battelle's proposal commits \$89 million in participant funds and seeks \$89 million in matching funds through the American Recovery and Reinvestment Act.

In August, BPA joined public and private partners throughout the U.S. portion of the Western Interconnection in a Western Electricity Coordinating Council application for Department of Energy funding to facilitate investment in a specific smart grid technology. On Oct. 27, 2009, the president announced \$3.4 billion in Recovery Act funding for smart grid initiatives, including \$53.9 million for the WECC project. BPA is investing \$20 million as its share of participant matching funds.

The project will deploy a large-scale synchronized phasor measurement system with selected smart grid functions. It involves infrastructure and software applications to improve situational awareness, systemwide modeling, performance analysis and wide-area monitoring and controls for the Western Interconnection.

Benefits will include avoiding large scale outages and faster restoration of the system, increased transfer capability, better congestion management and improved use of and reduced costs for supporting variable renewable generation.

Energy efficiency

We continue to pursue the potential synergy between the smart grid and energy efficiency. This past winter, five commercial buildings in Seattle reduced their power demand 10 to 20 percent during peak power use hours in a demand response pilot project sponsored by BPA and Seattle City Light. With these encouraging results, the pilot has been expanded to address summer peak loads and will shortly add a residential demand response pilot.

Climate change

Climate change and regulatory action on greenhouse gasses are already changing

the power system, creating rapid demand for emission-free renewable energy. We completed an initial roadmap for addressing climate change in December as a starting point for discussions with the region on how best to reflect climate change concerns in our business practices and initiatives. The roadmap lays out dozens of actions BPA is taking internally to prepare for and respond to climate change. For example, the University of Washington is developing a model to let BPA track the physical effects of climate change on the Columbia River system and model the effects on the hydro system.

These and other initiatives are examples of how we are working in partnership with others to build a better future.

Delivering Value

Just three years ago, BPA adopted three core values. These are the attributes we want our agency to be identified with. They are trustworthy stewardship, collaborative relationships and operational excellence.

Operational excellence

While each value is equally important, we have focused on a particular core value each year. This year, our focus was on “operational excellence.” For us, operational excellence not only stands for outstanding performance but also means seeking continuous improvement.

This year’s achievements reflect our efforts to provide the Pacific Northwest with the

highest value through excellent and continually improving service to deliver on our mission. That mission is and continues to be to assure the Pacific Northwest:

1. An adequate, efficient, economical and reliable power supply;
2. A transmission system that is adequate to the task of integrating and transmitting power from federal and nonfederal generating units, providing service to our customers, providing interregional interconnections, and maintaining electrical reliability and stability; and
3. Mitigation of the Federal Columbia River Power System’s impacts on fish and wildlife.





Facilitating renewable energy

We are aiming to double the amount of wind resources connected to our transmission grid within the next two years.

Performance Target Results

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

Stakeholder Perspective

Transmission System Infrastructure

Target met. BPA made transmission system infrastructure investments totaling \$239 million. BPA met its capital budget allocation target of 80 percent and capital expenditure target of 80 percent with results of 99 percent and 98 percent, respectively. BPA also met cost and schedule milestones for 21 out of 23 high impact capital projects, a result of 91 percent against a target of 85 percent.

Commercial Infrastructure

Target met. BPA completed a commercial infrastructure analysis in a record of decision that determined which of the projects secured through the fiscal year 2008 Network Open Season will be offered at embedded rates. The Open Access Transmission Tariff changes resulting from Network Open Season were filed with the Federal Energy Regulatory Commission. BPA collaborated with stakeholders to develop the planning, coordination and commercial requirements for an Intertie Open Season. In March 2009, BPA began offering Conditional Firm transmission service – a new type of product that offers transmission service over constrained paths when transmission inventory cannot accommodate long-term firm transmission requests.

Resource Program

Target met. BPA successfully released a draft Resource Program document that guides the types, timing and amount of BPA resource acquisitions through 2019. The draft Resource Program considers the amount of resources needed depending on a wide range of outcomes involving customers' power supply preferences, carbon regulation, economic growth and other possibilities.

Hydro Generation System Infrastructure

Target met. BPA made infrastructure investments totaling \$128.5 million across 31 hydro generation plants, including \$110 million for generation reliability and \$18.5 million for generation efficiency enhancements (largely turbine runner upgrades). BPA met its 80 percent target for the capital investment program expenditure rate with a result of 91.4 percent and met its milestone completion rate of 70 percent with a result of 87 percent.

Energy Efficiency/Demand Management

Target met. BPA achieved over 70 average megawatts of new conservation savings based on a target of 52 to 57 average megawatts and did so based on an average cost of under \$1.2 million per average megawatt, versus a target of between \$1.4 million to \$1.5 million. BPA will continue its public process on the future role of energy efficiency post-2011 to ensure regional collaboration.

Transmission Reliability

Target met. The BPA transmission system experienced no high-risk, high-severity level violation of reliability compliance standards and no vegetation-caused line outages. BPA did not experience any involuntary curtailments of firm load due to a reliability violation, transmission system security breach or cascading outage originating on the BPA system. BPA also met its target for meeting the milestones for all Western Electricity Coordinating Council approved or revised mitigation plans.

Transmission Availability

Target met. BPA's most important transmission lines were available for service 98.8 percent of the time, exceeding the target of 98 percent.

Generation Reliability

Target met. The Federal Columbia River Power System's generators experienced no high-risk violation of reliability compliance standards at any level and experienced no involuntary curtailment of firm load due to inadequate power supply or breach of generation system security. BPA also met the target compliance requirements for the generation-related Western Electricity Coordinating Council approved or revised mitigation plans.

Generation Availability

Target met. BPA and its Federal Columbia River Power System partners achieved 100.2 percent of planned heavy-load-hour availability, exceeding the target of 97.5 percent.

Columbia Generating Station Performance and Cost

Target not met. The cost of power at Columbia Generating Station was \$49.36 per megawatt-hour, within the target range of \$49.08 and \$54.28 per megawatt-hour. However, due to forced power reductions and unplanned outages, the overall performance indicator was 76.47 points, falling short of the target of 85.66 points.

Regional Dialogue Implementation

Target met. BPA signed 20-year Regional Dialogue contracts with all of its 135 preference customers and signed Residential Purchase and Sales Agreements with three investor-owned utilities. BPA also achieved the following tasks: developed an implementation plan and met milestones for Regional Dialogue and all related projects; developed Tier II product and service options for the fiscal years 2012-2014 commitment period; and completed contracts and procedures for managing delivery of nonfederal power to customers with Transfer Service Agreements.

Wind Integration

Target met. BPA successfully completed the following actions to reliably integrate wind generation: refined estimates of reserve requirements for wind balancing; assessed the Federal Columbia River Power System's capacity and flexibility to supply wind balancing; and implemented reliability protocols that require increased accuracy in wind forecasts and schedules.

Power and Transmission Rate Case

Target met. BPA successfully kept rates low through the completion of the rate case, implementing new wholesale power rates and transmission and ancillary service rates effective Oct. 1, 2009.

ESA Compliance

Target met. BPA met its implementation requirements for the 2008 biological opinion and fish Accords with no court action resulting in a “material change.”

Climate Change Action Plan

Target met. BPA successfully implemented 92 percent of the fiscal year 2009 components of its Climate Change Action Plan, against a target of 88 percent. The action plan represents an integrated approach to addressing climate change. It identifies measures related to physical effects of climate change on the Columbia River hydro system that could affect BPA's operations or policies.

30

Financial Perspective

Modified Net Revenue

Target not met. Due to low net secondary sales caused by below average streamflows and low market prices, BPA's modified net revenue was negative \$187 million against a target range of \$5 million to \$175 million.

Treasury Payment

Target met. BPA's fiscal year 2009 payment to the U.S. Treasury of \$845 million was made on time and in full for the 26th consecutive year. The payment consisted of \$432 million for principal, \$367 million for interest and \$46 million for other obligations.

Bond Rating

Target met. BPA-backed bonds achieved or maintained ratings of “AA” or better from all three agencies (Standard & Poor's, Moody's and Fitch). Fitch upgraded BPA-backed Energy Northwest bonds from AA- to AA with a positive outlook. Standard & Poor's upgraded Energy Northwest bonds from AA- to AA with a stable outlook. Moody's retained its rating of Aaa, the highest rating possible.

Internal Operating Cost

Target met. BPA realized internal operating costs of \$599 million against a target range of \$594 million to \$609 million.

Access to Capital

Target met. BPA completed an action plan to sustain access to capital over the next 20 years. The American Recovery and Reinvestment Act increased BPA's Treasury borrowing authority by \$3.25 billion to stimulate economic growth and create jobs.

Internal Operations Perspective

Transmission Process Improvement Projects

Target not met. BPA implemented the following three transmission process improvement programs within schedule and budget targets: Supplemental Labor Information Management System, Enterprise Geospatial Information System and Field Connectivity. However, the following projects experienced delays: E-Commerce, Work Planning and Scheduling System, and Transmission Asset System.

Customer Billing and Contracts System

Target not met. BPA did not meet scheduled deliverables due to project delays. The billing system is now on track to be implemented in early fiscal year 2010 and the contracts management system will follow in fiscal year 2011.

Business Continuity Program

Target met. BPA developed business continuity business practices, achieving all major milestones to build and develop improved emergency response, infrastructure restoration and crisis and incident management capabilities. BPA also achieved 12 of 13 major milestones to close gaps in the continuity of operations area.

People and Culture Perspective

Workforce Gap Closure

Target met. BPA implemented 92 percent of 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, employee understanding of BPA's business strategy was 82 percent, above the target range of 70 to 80 percent.

Safety

Target met. BPA achieved a lost-time frequency rate of 1.3 per 200,000 hours worked, which is below BPA's target of less than or equal to 1.5, and significantly below the industry lost-time frequency rate target of 2.1 as reported by the Bureau of Labor Statistics. In addition, no fatalities occurred to BPA employees or contract employees working on BPA facilities.



Financial Section



Forward-Looking Information

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

New long-term power sales contracts

At the end of calendar year 2008, BPA signed new wholesale power contracts with its preference customers and some investor-owned utilities to cover fiscal years 2012-2028. Preference customers are electric power utilities in the region that are cooperatively-owned or consumer-owned, such as municipalities, people’s utility districts and public utility districts. Under federal law, these entities have priority access to BPA’s electric power. The new contracts are expected to provide BPA and its preference customers with greater long-term financial stability and protection from a volatile energy market through a new tiered rate structure.

Preference customers will have a contract-defined right to purchase an amount of power at Tier 1 rates. Power at Tier 1 rates would be limited to the output of the existing resources of the federal system as of fiscal year 2011, together with limited potential additional resources, the amount of which is capped by contract. Tier 1 rates are expected to remain relatively low and stable because they

recover the cost of the existing federal system, which in aggregate is and is expected to be a low-cost portfolio of generating resources.

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

Resource Program

BPA is developing a Resource Program in coordination with the Northwest Power and Conservation Council’s Sixth Power Plan. The draft Resource Program examines BPA’s projected load-resource balance and describes how to fill any projected deficits by analyzing the costs, risks and environmental characteristics of potential generating and electric power conservation resource types. BPA issued a draft Resource Program in September 2009 and expects to issue a final in December 2009.

Rates

The Pacific Northwest Electric Power Planning and Conservation Act of 1980 directs BPA to establish and periodically review and revise rates for the sale and disposition of electric energy and capacity and for the transmission of nonfederal power. Rates are to be set to recover, in accordance with sound business principles, the costs associated with the acquisition, conservation and transmission of electric power, including the amortization of the federal investment in the Federal Columbia River Power System over a reasonable period of years. BPA filed an amended power rate proposal for the three-year rate period beginning with fiscal year

2007 with the Federal Energy Regulatory Commission for its review and approval. On Oct. 31, 2008, FERC granted interim approval of the proposed rates, as amended by BPA, pending final review.

The revised rates were in place for the entire year. As in the original rate filing, these rates for fiscal year 2009 again included a Cost Recovery Adjustment Clause to allow BPA a temporary upward adjustment to power rates of up to \$36 million (the CRAC cap). The CRAC is triggered when accumulated modified net revenues reach thresholds as established in the rate case. A Dividend Distribution Charge, which could reduce rates under certain circumstances, was also included. These adjustments were not needed in fiscal year 2008, and were also not necessary for fiscal year 2009. However, the rates also included a National Oceanic and Atmospheric Administration Fisheries Biological Opinion Emergency Surcharge for a qualifying within-year adjustment triggered by certain events associated with the litigation over the 2004 Biological Opinion and an agency Treasury Payment Probability below 80 percent. BPA's financial conditions did not deteriorate sufficiently during fiscal year 2009 and there also were not significant fish costs associated with a qualifying trigger event requiring the rate adjustment.

New rates for fiscal years 2010-2011 were set and went into effect on Oct. 1, 2009. Should the events described above occur, they could trigger the cost recovery rate adjustments.

Direct-service industries

BPA has not yet made a decision about service to direct-service industrial customers post 2011. The agency continues to explore various means of providing service benefits that will provide the region with known, capped costs. BPA is primarily considering power deliveries, which would be priced at the Industrial Firm Power Rate, as

developed in future rate cases and consistent with a Ninth Circuit Court opinion describing prudent business practices. BPA is continuing discussions with two aluminum companies and one paper company for potential contracts.

Transmission

Following the 2008 Network Open Season for customers seeking capacity on BPA's transmission system network and subsequent cluster studies, BPA elected to explore four transmission projects. One, the McNary-John Day transmission line, began construction in the summer of 2009. BPA is preparing environmental review of three other key transmission projects and has not yet made a final decision to build. Together, these four projects would add more than 225 miles of lines to the Northwest transmission grid.

BPA also conducted a successful second Network Open Season in 2009. Like the first, the bulk of the requests were associated with wind energy projects. The agency is now conducting cluster studies to determine aggregate net impacts of all service requests. It is expected that the cluster studies may show that new transmission will be needed. The studies will also help determine the costs of any investments in new infrastructure and whether there is sufficient contractual commitment from customers to cover these incremental costs in transmission service rates.

Fish and wildlife

Litigation related to biological opinions issued by National Oceanic and Atmospheric Administration Fisheries has been ongoing for several years. The biological opinions govern how the federal hydropower system should be operated to protect and recover endangered species. While BPA is not a party to the suits brought by environmental groups, the outcome of litigation would affect Northwest

ratepayers since BPA incurs the bulk of costs, both direct expenditures and lost revenues, related to hydro operations on behalf of endangered fish.

While it is difficult to predict future financial impacts, there have been some positive developments. In late August 2008, the U.S. District Court of Oregon signaled a non-litigative approach, encouraging the parties to continue talking through the issues rather than subjecting the current biological opinion to a science review. Additionally, the Columbia Basin Fish Accords with three federal agencies, five Northwest tribes, Columbia River Inter-Tribal Fish Commission and two states commit BPA to funding specific fish and wildlife programs for 10 years. In return, the parties have agreed that the federal government's requirements under the Endangered Species Act, Clean Water Act and Northwest Power Act are satisfied for the next nine years and that they will support these agreements in all appropriate venues.

In September 2009, the Obama administration weighed in on the biological opinion at the court's request and concluded that the 2008 biological opinion is biologically and legally sound and is based on the best available scientific information. The administration found that there are uncertainties in some predictions regarding the future condition of the listed species due to potential effects of such things as climate change and ocean conditions. To address these uncertainties, the administration included an Adaptive Management Implementation Plan that includes, as a last resort, the possibility of breaching the four lower Snake River dams.

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

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

Environmental

From time to time, there are environmentally compromised sites where BPA, U.S. Army Corps of Engineers or Bureau of Reclamation have been or may be identified as a potential responsible party. Costs associated with cleanup of those sites are not expected to be material to the Federal Columbia River Power System financial statements and would be recoverable through future rates.



Management's Discussion & Analysis

Results of operations

OPERATING REVENUES

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

	2009	2008	2007
Gross sales:			
Power	\$2,090,387	\$2,323,087	\$2,578,749
Transmission	689,197	683,964	652,172
Bookouts	(36,814)	(109,704)	(94,705)
.....			
Sales	2,742,770	2,897,347	3,136,216
Derivative instruments	(34,677)	(30,564)	(6,519)
U.S. Treasury credits for fish	99,499	100,392	66,097
Miscellaneous revenues:			
Power	37,982	31,895	35,730
Transmission	24,710	37,548	37,116
Total operating revenues	\$2,870,284	\$3,036,618	\$3,268,640

Fiscal year 2009 revenues compared to fiscal year 2008

For the fiscal year ended Sept. 30, 2009, Power Services and Transmission Services consolidated gross sales decreased \$228 million, or 8 percent, from the prior year.

Power Services gross sales decreased \$233 million, or 10 percent. The change was primarily due to the following key factors:

- Revenues were down \$490 million from fiscal year 2008 due to the downturn in the economy resulting in lower demand as well as reduced runoff and lower market prices. A typical metric to measure runoff is million acre-feet. Runoff measured at The Dalles Dam was 117 maf and 126 maf for fiscal years 2009 and 2008, respectively, compared to the historical average

of 133 maf. Lower market prices for electricity were mainly driven by lower natural gas prices.

- Reduced Columbia Generating Station output was due to planned and unplanned outages.
- The WP-07 Supplemental Rate Case revised BPA's power rates for fiscal year 2009, resulting in non-slice PF rates being about 1 percent lower than the fiscal year 2008 rates.
- The decrease in revenue was offset by the effects of the Residential Exchange Program refunds. Refunds under the program were approximately \$83 million and \$341 million in fiscal years 2009 and 2008, respectively, which results in a net \$257 million increase in revenue.

Transmission Services gross sales increased \$5 million, or 1 percent. The change was primarily due to the following key factors:

- An increase in ancillary services, primarily due to the introduction of a new product called within-hour balancing for resources and regulation and frequency response.

- An overall decrease in Network sales driven by a decrease in Point-to-Point short-term sales that were caused by a lower spring runoff. An increase in Point-to-Point long-term sales partially offset the decrease of Point-to-Point short-term sales.

BPA's revenues from electricity sales and expenses associated with non-trading energy activities that are booked out (settled other than by the physical delivery of power) are reported on a net basis in both operating revenues and purchased power expense. The accounting treatment has no effect on net revenue, cash flows or margins.

The increase in the unrealized loss of BPA's derivative instruments of \$4 million, or 13 percent, was due primarily to the following key factors:

- Decrease in the 10- and 15-year forward Libor swap curves;
- Decrease in the forward power price curve and its effect on BPA's commodity derivative instruments.

Fiscal year 2008 revenues compared to fiscal year 2007

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

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

- In fiscal year 2008 there was a downward adjustment of \$341 million due to the impacts of the WP-07 Supplemental Wholesale Power Rate Case proceeding on the Residential Exchange Program.
- There was a slight increase in long-term contractual obligations and sales under existing contracts resulting in a \$24 million increase in revenues from firm power sales.
- Runoff as measured at The Dalles Dam was 126 million acre-feet and 122 maf for fiscal years 2008 and 2007, respectively.

- Due to a below-average water year and a delayed but rapid runoff, BPA purchased an additional 1 million megawatt-hours of power in the spring to meet projected river operation needs. Once these needs were met, remaining power was sold at a slightly higher price, resulting in a \$61 million increase in revenues.

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

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

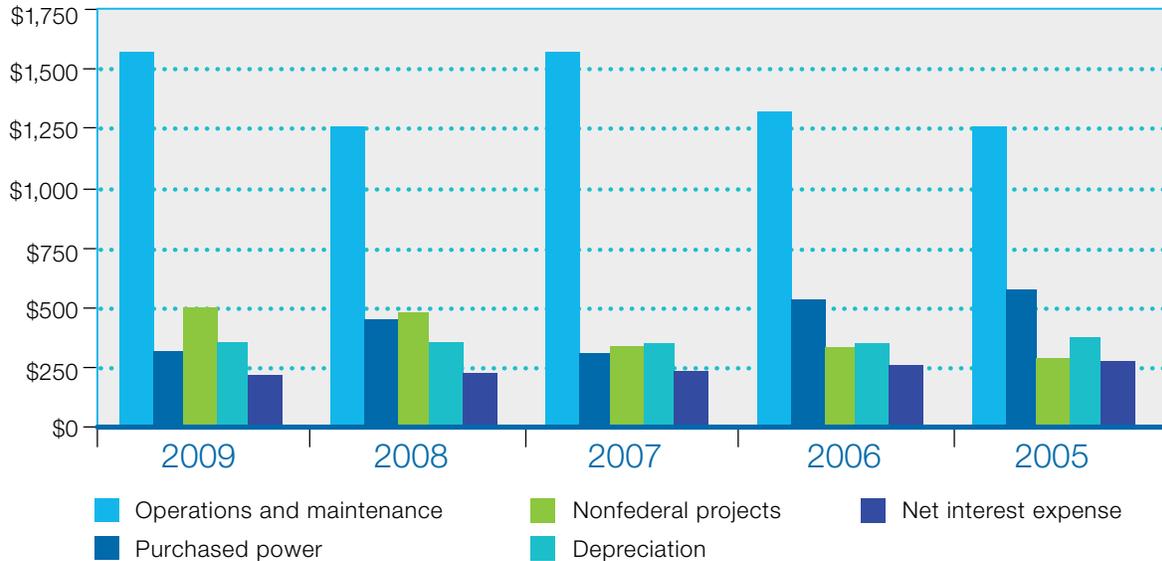
- Network and intertie transmission sales and their associated ancillary services increased. Significant reasons for the increased revenues were increased Point-to-Point and intertie long-term and Point-to-Point short-term sales. There was also a slight increase in Point-to-Point and intertie long-term rates compared to fiscal year 2007.
- The increase in revenues was offset primarily by elimination of revenues from customers using ancillary service product reactive supply and voltage from generation.

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

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

Expenses by category

Millions of dollars



Fiscal year 2009 expenses compared to fiscal year 2008

For the fiscal year ended Sept. 30, 2009, operating expense increased \$209 million, or 8 percent from fiscal year 2008. Operations and maintenance increased \$322 million, or 26 percent, from the prior fiscal year, as reported in the Combined Statements of Revenues and Expenses, due primarily to: \$206 million associated with the effects of the Residential Exchange Program; \$51 million increase in Energy Northwest Columbia Generating Station scheduled maintenance and biennial refueling; and \$29 million increase in fish and wildlife expense. Purchased power expense decreased \$132 million, or 29 percent, due to lower market prices and volume of purchases, offset by an increase in purchased power due to the unplanned outage at CGS. Nonfederal projects debt service increased \$22 million, or 5 percent, due to increased Libor interest expense and repayment for Columbia Generating Station debt, partially offset by lower repayment of Energy Northwest's terminated nuclear facilities debt.

Interest expense for the fiscal year ended Sept. 30, 2009, decreased \$14 million, or 4 percent, compared to fiscal year 2008 as the weighted-average interest rate on federal appropriations decreased. Interest income decreased \$3 million, or 4 percent, due to lower cash balances and lower interest rates.

Fiscal year 2008 expenses compared to fiscal year 2007

For the fiscal year ended Sept. 30, 2008, operating expenses decreased \$31 million, or 1 percent, from fiscal year 2007. Operations and maintenance decreased \$313 million, or 20 percent, for the fiscal year from the prior year, as reported in the Combined Statements of Revenues and Expenses. The decline was the result of a \$341 million provision for rate refunds related to the Residential Exchange Program. Purchased power increased \$140 million, or 45 percent, due to a combination of higher prices and increased purchases, as a consequence of delayed runoff and the associated reduction in federal generation. Nonfederal projects debt service increased \$136 million, or 40 percent,

due to increased amortization for Energy Northwest Nuclear Project No. 1 and Project No. 3 bonds. The lower amortization for fiscal year 2007 was the result of extension of nonfederal debt and early repayment of federal debt within the total Federal Columbia River Power System debt portfolio.

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

Selected quarterly information

Due to winter heating loads for Northwest utilities, the second quarters normally have the highest revenues. This was the case for fiscal years 2009 and 2007; however, the late snow melt in fiscal year 2008 resulted in increased secondary sales in the third quarter. Maintenance on transmission facilities occurs mainly during summer, usually resulting in higher operating expenses for the fourth quarters. The Residential Exchange Program adjustment of \$341 million previously discussed was booked in the fourth quarter of fiscal year 2008.

Selected quarterly information

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

	Dec 31	Mar 31	Jun 30	Sep 30	Totals
2009					
Revenues	\$ 763,040	\$ 787,348	\$ 700,961	\$ 653,612	\$ 2,904,961
Derivative instruments	(39,947)	4,924	2,957	(2,611)	(34,677)
Operating revenues	723,093	792,272	703,918	651,001	2,870,284
Operating expenses	685,532	688,465	624,871	754,037	2,752,905
Net interest expenses	54,207	53,093	60,763	50,366	218,429
Net (expenses) revenues	\$ (16,646)	\$ 50,714	\$ 18,284	\$(153,402)	\$ (101,050)
2008					
Revenues	\$ 797,440	\$ 847,936	\$ 904,447	\$ 517,359	\$ 3,067,182
Derivative instruments	(16,120)	(48,313)	37,824	(3,955)	(30,564)
Operating revenues	781,320	799,623	942,271	513,404	3,036,618
Operating expenses	691,211	657,083	717,809	477,702	2,543,805
Net interest expenses	55,616	54,463	55,557	62,332	227,968
Net revenues (expenses)	\$ 34,493	\$ 88,077	\$ 168,905	\$ (26,630)	\$ 264,845
2007					
Revenues	\$ 819,166	\$ 868,151	\$ 841,415	\$ 746,427	\$ 3,275,159
Derivative instruments	(238)	12,521	(10,509)	(8,293)	(6,519)
Operating revenues	818,928	880,672	830,906	738,134	3,268,640
Operating expenses	662,827	617,544	585,595	708,719	2,574,685
Net interest expenses	63,413	62,801	59,802	50,731	236,747
Net revenues (expenses)	\$ 92,688	\$ 200,327	\$ 185,509	\$ (21,316)	\$ 457,208

Liquidity and capital resources

OPERATING ACTIVITIES

Cash provided by operating activities of the FCRPS decreased from \$873 million for fiscal year ended Sept. 30, 2008, to \$208 million for the fiscal year ended Sept. 30, 2009, as reported in the Combined Statements of Cash Flows. The FCRPS incurred net expenses of \$101 million for the fiscal year ended Sept. 30, 2009. By comparison, net revenues were \$265 million for the fiscal year ended Sept. 30, 2008. The net change attributable to settlement of the IOU residential exchange benefits was \$138 million outflow.

Cash provided by operating activities of the FCRPS increased from \$872 million for fiscal year ended Sept. 30, 2007, to \$873 million for the fiscal year ended Sept. 30, 2008, as reported in the Combined Statements of Cash Flows. The change in operating cash flow primarily reflects the changes in net revenues and differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities. The net change attributable to settlement of the IOU residential exchange benefits was \$85 million outflow.

INVESTING ACTIVITIES

When compared to the fiscal year ended Sept. 30, 2008, cash used for investing activities of the FCRPS increased \$347 million to \$803 million for the fiscal year ended Sept. 30, 2009. Utility plant investment increased \$163 million, driven primarily by investments for additional transmission assets and at generating facilities. Under its new banking arrangement with the U.S. Treasury, BPA has agreed to invest at least \$100 million annually for up to 10 years or until the BPA fund is fully invested. During the fiscal year ended Sept. 30, 2009, the consolidated special purpose corporations deposited \$200 million into their restricted trust funds and advanced \$108 million to the BPA fund to support transmission construction activities on leased projects. This represents a net outflow of \$83 million when compared to the same activity for the fiscal year ended Sept. 30, 2008.

Cash used for investing activities of the FCRPS decreased from \$469 million for the fiscal year ended Sept. 30, 2007, to \$455 million for the fiscal year ended Sept. 30, 2008. There was a transfer of approximately \$49 million to BPA from the federal Spectrum Relocation fund during fiscal year 2007. These funds are required to be used for construction and replacement of telecommunications facilities and equipment over the next few years. As such, the receipts are reflected as a source of investing cash. The special purpose corporations borrowed an additional \$74 million during fiscal year 2008 for the Lease Financing Program, which resulted in an increase in trust fund borrowing deposits of \$23 million over the prior fiscal year.

FINANCING ACTIVITIES

Compared to \$162 million used for financing activities for the comparable period a year earlier, cash provided by financing activities of the FCRPS was \$221 million for the fiscal year ended Sept. 30, 2009. Federal appropriations increased primarily due to funding for capital and operations and maintenance investments at the generating facilities. Nonfederal debt increased primarily as a result of the Lease Financing Program special purpose corporations' borrowings for transmission infrastructure.

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

CASH BALANCES AND BPA RESERVES

At Sept. 30, 2009, the FCRPS ending cash balance on the Combined Balance Sheet was \$1.357 billion. BPA's fiscal year-end cash balance, excluding funds transferred from the Spectrum Relocation fund, was \$1.117 billion and the Corps and Reclamation combined fiscal year-end cash balance was \$240 million.

BPA's year-end reserves for fiscal years 2009, 2008 and 2007 were \$1.363 billion, \$1.646 billion and \$1.463 billion, respectively. For fiscal year 2009 BPA reserves are comprised of \$1.117 billion in cash, \$146 million in deferred borrowing and \$100 million of investments in U.S. Treasury securities. 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 2008 and 2007, BPA's fiscal year-end cash and deferred borrowing authority were \$1.571 billion and \$75 million, and \$1.328 billion and \$135 million, respectively.

BPA STATUTORY BORROWING AUTHORITY

In February 2009, the president approved the \$787 billion American Recovery and Reinvestment Act. The Recovery Act provides BPA with an additional increment of \$3.25 billion in U.S. Treasury borrowing authority under the Federal Columbia River Transmission System Act of 1974. BPA is authorized to use this borrowing authority for multiple purposes, including to expand and upgrade its transmission system for diverse purposes such as the integration and transmission of new renewable electricity resources, energy efficiency and to meet its obligations under the Pacific Northwest Electric Power Planning and Conservation Act of 1980. This increase brings the aggregate principal amount of U.S. Treasury debt BPA is authorized to have outstanding at any one time to \$7.70 billion.

The term of U.S. Treasury borrowings for capital programs that BPA currently funds using U.S. Treasury borrowing authority is limited as follows: 45 years for Corps and Reclamation capital investments, 35 years for transmission facilities, 15 years for fish and wildlife and environment projects and five years for conservation projects. As of Sept. 30, 2009, BPA had \$2.13 billion of U.S. Treasury debt outstanding. The terms of the outstanding U.S. Treasury borrowings vary from three to 34 years. U.S. Treasury debt can be issued with call options. At Sept. 30, 2009, BPA had 33 callable borrowings on its books totaling \$1.104 billion. The interest on BPA's outstanding borrowings from U.S. Treasury is set at rates comparable to the rates prevailing in

the market for similar bonds issued by government corporations. As of Sept. 30, 2009, the interest rates on the outstanding U.S. Treasury borrowings ranged from 2.8 percent to 6.7 percent with a weighted-average interest rate of approximately 5.0 percent.

LEASE FINANCING PROGRAM

BPA has entered into separate arrangements with four special purpose corporations, Northwest Infrastructure Financing Corporation and Northwest Infrastructure Financing Corporations II, III and IV. These corporations are consolidated with BPA. The Lease Financing Program enables BPA to continue to invest in infrastructure to support a safe and reliable system for the transmission of power with an 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, which was energized in December 2005, the construction costs of which were financed by NIFC through a \$120 million taxable bond issuance. The lease expires and the bonds mature in 2034. Payment of the debt service on the bonds is secured solely by BPA's lease payments to NIFC with respect to the project.

BPA has entered into umbrella leases for \$90 million with NIFC II in June 2007, \$200 million with NIFC III in March 2008, and \$100 million with NIFC IV in January 2009. BPA consequently entered into several lease commitments with each of these entities for individual transmission assets. The construction costs of the assets are being financed through bank lines of credit between the respective NIFC entities and Citibank N.A., JPMorgan Chase Bank, N.A. and Bank of America, N.A. Payment of the debt service on the lines of credit is secured solely by BPA's lease payments to the NIFC entities with respect to the related transmission assets. BPA has been retained as construction agent to construct and install the leased assets and expects that construction of most of the assets will be completed over the next few years. Under the agreements, the NIFC entities have leased the assets to BPA until fiscal years 2014, 2015 and 2016, at which point BPA may acquire the assets for a bargain purchase

price, negotiate the extension of the lease for a longer term, or arrange for the transfer of the assets to a separate owner and lease the assets from the new owner. BPA's current expectation is that it will enter into a subsequent lease for the assets and that BPA's lease payments for such lease will secure long-term financing that will better match the assets' useful lives, the proceeds of which will be used to repay the bank lines of credit.

TREASURY PAYMENT

BPA paid the U.S. Treasury \$845 million for fiscal year 2009, making it the 26th consecutive year in which BPA has made its payments on time and in full. The fiscal year 2009 payments included \$432 million in principal and \$367 million in interest for U.S. Treasury debt and for the appropriated federal investment in the FCRPS. This fiscal year's principal payment included \$234 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 \$46 million in other obligations, including \$33 million of additional funding for post-retirement benefit programs provided to employees associated with the operation of the FCRPS. Payments made in fiscal years 2008 and 2007 were \$963 million and \$1.045 billion, including \$211 million and \$289 million, respectively, to repay federal appropriations and

bonds issued to the U.S. Treasury in excess of those scheduled in FERC filings.

CREDIT RATINGS

Credit ratings on nonfederal debt backed by BPA at Sept. 30, 2009, were as follows:

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

Contractual obligations and federal payments

Amounts shown in the following table for federal appropriations, borrowings from U.S. Treasury and nonfederal debt include interest and therefore are higher than amounts reflected in the Combined Balance Sheets and described in the accompanying Notes to Financial Statements — Note 6, Federal Appropriations; Note 7, Borrowings from U.S. Treasury; and Note 8, Nonfederal Debt. Asset retirement obligations also include interest and are described in Note 2, Asset Retirement Obligations. Purchase power commitments are a period expense. Irrigation assistance is treated as a distribution from accumulated net revenues when paid. These are described in Note 12, Commitments and Contingencies.

Contractual obligations and federal payments

As of Sept. 30 — thousands of dollars

	2010	2011	2012	2013	2014	2015+	Total
Federal appropriations	\$ 261,376	\$ 278,556	\$ 280,432	\$ 272,297	\$ 271,931	\$10,628,529	\$11,993,121
Borrowings from U.S. Treasury	462,878	408,144	335,081	182,718	156,306	1,715,463	3,260,590
Nonfederal debt	649,249	618,461	763,521	836,254	987,775	5,015,487	8,870,747
Purchase power commitments	84,566	70,692	83,805	75,898	78,756	602,970	996,687
Asset retirement obligations	9,698	10,659	11,744	14,102	17,025	644,450	707,678
Irrigation assistance	—	—	1,182	58,822	52,426	553,791	666,221
Total	\$1,467,767	\$1,386,512	\$1,475,765	\$1,440,091	\$1,564,219	\$19,160,690	\$26,495,044

OFF-BALANCE SHEET ARRANGEMENTS

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

Critical accounting policies and estimates

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

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 periods of time that differ from normal treatment under generally accepted accounting principles. Under those circumstances, regulatory assets or liabilities are recorded, and such costs or credits are amortized either during the periods they are scheduled in rates or as the nonfederal projects debt is repaid in accordance with authoritative guidance for Regulated Operations.

In order to defer incurred costs, 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, any deferred costs and revenues would be expensed and recognized, respectively, in the Combined Statement of Revenues and Expenses in that period. Since BPA's rates are not structured to provide a rate of return on rate base assets, regulatory assets are recovered at cost without an additional rate of return. See Note 3, Effects of Regulation, for tables

summarizing regulatory assets and liabilities as of Sept. 30, 2009, and 2008. Amortization of these assets and liabilities is reflected in the Combined Statements of Revenues and Expenses.

Quantitative and qualitative disclosures about market risk

RISK MANAGEMENT

Due to the operational risk posed by fluctuations in river flows and electric market prices, net revenues that result from underlying surplus or deficit energy positions are inherently uncertain. BPA's Transacting Risk Management Committee has responsibility for the oversight of the market price, inventory and credit risks that arise from transacting in power markets. The TRMC establishes risk tolerances and limits that are represented in the transactional risk policy. This policy defines the control environment through which these risks are managed. Experienced business and risk analysts and managers conduct simulation and analysis of the hydro supply system and forward market prices to derive market price and credit risk positions. These results are measured against risk limits and reported to senior management daily. See Note 10, Risk Management and Derivative Instruments, for additional disclosure related to Commodity, Volumetric, Credit and Interest Rate risk.

Non-GAAP financial information

FISH AND WILDLIFE

The Northwest Power Act directs BPA to protect, mitigate and enhance fish and wildlife resources to the extent they are affected by federal hydroelectric projects on the Columbia River and its tributaries. BPA makes expenditures and incurs other costs for fish and wildlife consistent with the Northwest Power Act and the Northwest Power and Conservation Council's Columbia River Basin Fish and Wildlife Program. Additionally, certain Columbia River System fish species are listed under the Endangered Species Act as threatened or

endangered. BPA is financially responsible for expenditures and other costs arising from conformance with the ESA and certain biological opinions prepared by the National Oceanic and Atmospheric Administration Fisheries 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 FCRPS, BPA has repaid the U.S. Treasury the share of the costs of mitigation by the Corps and Reclamation that is allocated by law or pursuant to policies promulgated by Federal Energy Regulatory Commission's predecessor to the federal projects' power purpose. These measures mitigate for the impact upon fish and wildlife from constructing and operating federal hydroelectric dams.

BPA also implements and funds measures proposed in the Council's program and the biological opinions. They call for a variety of mitigation measures from habitat protection to mainstem Columbia River and Snake River flow targets and mandatory spill for passing juvenile fish over dams. Such measures affect the operation of the FCRPS, reducing power generation, and either requiring BPA to purchase power to fulfill contractual demands or to forego revenue from sales of power. The financial impacts of these investments in fish and wildlife are counted as measures funded by BPA. Some of the Council's program measures, especially those designed to benefit species not listed under the ESA, are in addition to ESA-directed measures. However, with respect to the Council's program measures for listed species, many of the measures identified in the FCRPS biological opinions and in the Council's program overlap. BPA uses a comprehensive

approach to implementation described as "integrated," meaning the ESA requirements of the FCRPS biological opinions are incorporated with the broad fish and wildlife protection, mitigation and enhancement objectives of the Council's program, consistent with the Northwest Power Act.

BPA's fish and wildlife costs fall into two main categories, direct costs and operational impacts. Direct costs include integrated program costs, which are the costs to BPA of implementing the Council's program, and which include expense and capital components for ESA-related and non ESA-related measures that are located at sites away from the FCRPS dams; expenses for recovery of capital, which include depreciation, amortization and interest expenses for fish and wildlife capital investments by the Corps, Reclamation and BPA; and other entities' operation and maintenance, which include fish and wildlife operation and maintenance costs of the U.S. Fish and Wildlife Service for the lower Snake River hatcheries and of the Corps and Reclamation for FCRPS projects. Operational impacts are the second main category of fish and wildlife costs, which include replacement power purchase costs and estimated foregone power revenues. To determine these costs in a given year, BPA compares the actual hydroelectric generation in the year against the hydroelectric generation that would have been produced had the hydroelectric system been operating without any fish and wildlife operating constraints. To the extent that this comparison indicates that BPA made a power purchase to meet load, which purchase BPA would not have had to make had the river been operated free of fish constraints, BPA accounts for such value as a fish and wildlife cost.

Fish and wildlife

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

	2009	2008	2007
Direct costs	\$ 362	\$ 327	\$ 313
Operational impacts:			
Replacement power purchases	240	275	121
Estimated foregone power revenues	143	274	282
Total fish and wildlife	\$745	\$876	\$716

MODIFIED NET REVENUES

Modified net revenues are net revenues after removing the effects of the unrealized loss or (gain) on derivative instruments and nonfederal debt management actions that differ from rate case assumptions. Management has determined that modified net revenues are a better representation of the outcomes of normal operations during periods of debt management actions and fluctuations in derivative instruments market prices.

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

Under the Debt Optimization Program through Sept. 30, 2009, approximately \$2.6 billion in bonds issued by Energy Northwest have been refinanced with new bonds having final maturities mainly in

calendar years 2013-2018, with some extended to 2024. These actions reduced the expense for nonfederal projects included in operating expenses and increased net revenues reported in the Combined Statements of Revenues and Expenses. This is because the related regulatory assets are not amortized until the principal on the outstanding nonfederal bonds is repaid. As a result of the actions taken under the Debt Optimization Program, BPA prepaid federal appropriations and borrowings from U.S. Treasury of \$234 million, \$211 million and \$289 million in fiscal years 2009, 2008 and 2007, respectively. Since inception of the Debt Optimization Program, prepayments to the U.S. Treasury have increased accumulated net revenues by \$2.408 billion, \$2.175 billion and \$1.964 billion at Sept. 30, 2009, 2008 and 2007, respectively.

Modified net revenues were \$345 million lower for the fiscal year ended Sept. 30, 2009, compared to the prior fiscal year, primarily due to the decline in net revenues previously discussed.

The table below demonstrates the calculation for modified net revenues.

45

Modified net revenues

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

	2009	2008	2007
Net (expenses) revenues	\$ (101,050)	\$ 264,845	\$ 457,208
Derivative instruments	34,677	30,564	6,519
Nonfederal debt management actions	(120,853)	(137,963)	(246,421)
Modified net (expenses) revenues	\$ (187,226)	\$ 157,446	\$ 217,306



Financial Statements

Combined Balance Sheets

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

ASSETS

	2009	2008
Utility plant		
Completed plant	\$13,883,626	\$13,480,633
Accumulated depreciation	(5,106,884)	(4,933,348)
	8,776,742	8,547,285
Construction work in progress	985,624	890,883
Net utility plant	9,762,366	9,438,168
Nonfederal generation	2,520,245	2,492,645
Current assets		
Cash	1,357,019	1,731,238
U.S. Treasury market-based special securities	14,554	—
Accounts receivable, net of allowance	112,251	112,129
Accrued unbilled revenues	172,842	203,011
Materials and supplies, at average cost	77,612	75,719
Prepaid expenses	24,652	21,682
Total current assets	1,758,930	2,143,779
Other assets		
Regulatory assets	5,112,346	5,447,404
U.S. Treasury market-based special securities	83,041	—
Nonfederal nuclear decommissioning trusts	167,232	157,743
Deferred charges and other	235,119	176,045
Total other assets	5,597,738	5,781,192
Total assets	\$19,639,279	\$19,855,784

The accompanying notes are an integral part of these statements.

CAPITALIZATION AND LIABILITIES

	2009	2008
Capitalization and long-term liabilities		
Accumulated net revenues	\$ 2,556,272	\$ 2,664,460
Federal appropriations	4,392,405	4,247,972
Borrowings from U.S. Treasury	1,765,440	1,745,500
Nonfederal debt	6,244,954	6,182,403
Total capitalization and long-term liabilities	14,959,071	14,840,335
Commitments and contingencies (Note 12)		
Current liabilities		
Federal appropriations	3,784	9,889
Borrowings from U.S. Treasury	365,000	440,400
Nonfederal debt	319,980	284,469
Accounts payable and other	474,349	588,275
Total current liabilities	1,163,113	1,323,033
Other liabilities		
Regulatory liabilities	2,567,271	2,665,517
IOU exchange benefits	83,655	69,600
Asset retirement obligations	162,943	159,800
Deferred credits	703,226	797,499
Total other liabilities	3,517,095	3,692,416
Total capitalization and liabilities	\$19,639,279	\$19,855,784

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

	2009	2008	2007
Operating revenues			
Sales	\$2,742,770	\$2,897,347	\$3,136,216
Derivative instruments	(34,677)	(30,564)	(6,519)
U.S. Treasury credits for fish	99,499	100,392	66,097
Miscellaneous revenues	62,692	69,443	72,846
Total operating revenues	2,870,284	3,036,618	3,268,640
Operating expenses			
Operations and maintenance	1,578,421	1,256,213	1,569,504
Purchased power	317,543	450,035	310,073
Nonfederal projects	501,367	479,493	343,321
Depreciation and amortization	355,574	358,064	351,787
Total operating expenses	2,752,905	2,543,805	2,574,685
Net operating revenues	117,379	492,813	693,955
Interest expense and (income)			
Interest expense	326,494	340,658	344,379
Allowance for funds used during construction	(30,710)	(32,057)	(33,172)
Interest income	(77,355)	(80,633)	(74,460)
Net interest expense	218,429	227,968	236,747
Net revenues (expenses)	(101,050)	264,845	457,208
Accumulated net revenues at Oct. 1	2,664,460	2,402,565	1,945,357
Irrigation assistance	(7,138)	(2,950)	—
Accumulated net revenues at Sept. 30	\$2,556,272	\$2,664,460	\$2,402,565

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

Balance at Sept. 30	Accumulated Net Revenues	Federal Appropriations	Borrowings from U.S. Treasury	Nonfederal Debt	Total
2007	\$2,402,565	\$4,337,601	\$2,240,500	\$6,551,053	\$15,531,719
Federal construction appropriations:					
Increase	—	70,929	—	—	70,929
Repayment	—	(150,669)	—	—	(150,669)
Borrowings from U.S. Treasury:					
Increase	—	—	350,000	—	350,000
Repayment	—	—	(404,600)	—	(404,600)
Nonfederal debt:					
Increase	—	—	—	58,242	58,242
Repayment	—	—	—	(142,423)	(142,423)
Net revenues	264,845	—	—	—	264,845
Irrigation assistance	(2,950)	—	—	—	(2,950)
2008	\$2,664,460	\$4,257,861	\$2,185,900	\$6,466,872	\$15,575,093
Federal construction appropriations:					
Increase	—	176,887	—	—	176,887
Repayment	—	(38,559)	—	—	(38,559)
Borrowings from U.S. Treasury:					
Increase	—	—	338,000	—	338,000
Repayment	—	—	(393,460)	—	(393,460)
Nonfederal debt:					
Increase	—	—	—	287,944	287,944
Repayment	—	—	—	(189,882)	(189,882)
Net revenues	(101,050)	—	—	—	(101,050)
Irrigation assistance	(7,138)	—	—	—	(7,138)
2009	\$2,556,272	\$4,396,189	\$2,130,440	\$6,564,934	\$15,647,835

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

	2009	2008	2007
Cash provided by and (used for) operating activities			
Net revenues	\$ (101,050)	\$ 264,845	\$ 457,208
Noncash items:			
Depreciation and amortization	355,574	358,064	351,787
Unrealized loss on derivative instruments	34,706	30,535	6,641
Changes in:			
Receivables and unbilled revenues	32,561	6,721	62,736
Materials and supplies	(1,893)	(7,385)	3,431
Prepaid expenses	(2,970)	(1,744)	1,515
Accounts payable and other	(138,548)	240,592	(23,245)
Regulatory assets and liabilities	165,351	1,035,611	186,876
Other assets and liabilities	(135,690)	(1,054,411)	(174,664)
Cash provided by operating activities	208,041	872,828	872,285
Cash provided by and (used for) investing activities			
Investment in:			
Utility plant (including AFUDC)	(575,083)	(412,055)	(435,758)
Nonfederal generation	(27,600)	(27,415)	(30,165)
Transfer from Spectrum Relocation Fund	—	—	48,627
U.S. Treasury market-based special securities:			
Purchases	(110,000)	—	—
Maturities	9,891	—	—
Nonfederal nuclear decommissioning trusts	(8,211)	(7,300)	(6,691)
Special purpose corporations' trust funds:			
Deposits to	(199,916)	(74,474)	(51,070)
Receipts from	108,081	65,779	5,955
Cash used for investing activities	(802,838)	(455,465)	(469,102)
Cash provided by and (used for) financing activities			
Federal construction appropriations:			
Increase	176,887	70,929	125,972
Repayment	(38,559)	(150,669)	(112,100)
Borrowings from U.S. Treasury:			
Increase	338,000	350,000	265,000
Repayment	(393,460)	(404,600)	(506,300)
Nonfederal debt:			
Increase	287,944	58,242	66,148
Repayment	(189,882)	(142,423)	(30,353)
Customers:			
Advances for construction	63,492	70,356	44,434
Reimbursements to customers	(16,706)	(10,554)	(5,515)
Irrigation assistance	(7,138)	(2,950)	—
Cash provided by (used for) financing activities	220,578	(161,669)	(152,714)
(Decrease) increase in cash	(374,219)	255,694	250,469
Beginning cash balance	1,731,238	1,475,544	1,225,075
Ending cash balance	\$1,357,019	\$1,731,238	\$1,475,544
Cash paid for interest, net of U.S. Treasury credits	\$ 181,454	\$ 160,586	\$ 243,010
Supplemental schedule of noncash operating activities:			
Interest credits	\$ 73,839	\$ 108,385	\$ 64,104
U.S. Treasury credits	\$ 111,492	\$ 114,753	\$ 87,453

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

1. Summary of Significant Accounting Policies

ACCOUNTING PRINCIPLES

Combination and consolidation of entities

The Federal Columbia River Power System (FCRPS) financial statements combine the accounts of the Bonneville Power Administration (BPA), the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation) as well as the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan facilities. Consolidated with BPA are "Special Purpose Corporations" known as Northwest Infrastructure Financing Corporations (NIFCs), from which BPA leases certain transmission facilities (see Note 8, Nonfederal Debt).

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

FCRPS accounts are maintained in accordance with generally accepted accounting principles of the United States of America and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission (FERC). FCRPS accounting policies also reflect specific legislation and directives issued by U.S. government agencies. BPA is a component of the U.S. Department of Energy; Reclamation and U.S. Fish and Wildlife Service are part of the

U.S. Department of the Interior; and the Corps is part of the U.S. Department of Defense. U.S. government properties and income are tax-exempt.

Use of estimates

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

Reclassifications

Certain reclassifications were made to the fiscal years 2007 and 2008 combined financial statements from amounts previously reported to conform to the presentation used in fiscal year 2009. Such reclassifications had no effect on previously reported results of operations or 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 FERC. FERC's review is limited to three standards set out in the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act), 16 U.S.C. 839, and a standard set out by the Energy Policy Act of 1992, 16 U.S.C. 824. Statutory standards include a requirement that these rates be sufficient to assure repayment of the federal investment in the FCRPS over a reasonable number of years after first meeting BPA's other costs.

After final FERC approval, BPA's rates may be reviewed by the United States Court of Appeals for the Ninth Circuit (Ninth Circuit Court). Action seeking such review must be filed within 90 days of the final FERC decision. The Ninth Circuit Court may either confirm or reject a rate proposed by BPA.

In accordance with authoritative guidance for Regulated Operations (see Note 3, Effects of Regulation) certain costs or credits may be included in rates for recovery over a future period and are recorded as regulatory assets or liabilities. Regulatory assets or liabilities are amortized over the periods they are included in rates. Costs are recovered through rates during the periods when the costs are scheduled to be repaid. Amortization is computed using either the straight-line method or is based upon specific amounts included in rates each year. When the straight-line method is used, it is based upon either the estimated service lives or the periods the costs are included in rates. Since BPA's rates are not structured to provide a rate of return on rate base assets, regulatory assets are recovered at cost without an additional rate of return.

Utility plant

Utility plant is stated at original cost and primarily includes generation and transmission assets. Generation assets were \$7.6 billion and \$7.3 billion, and transmission assets were \$6.3 billion and \$6.2 billion at Sept. 30, 2009, and 2008, respectively. The costs of additions, major replacements and substantial betterments are capitalized. Cost includes direct labor and materials; payments to contractors; indirect charges for engineering, supervision and similar overhead items and an allowance for funds used during construction. Maintenance, repairs and replacements of items determined to be less than major units of property are charged to maintenance and operating expense as incurred. The cost of retiring utility plant units less any salvage proceeds is charged to accumulated depreciation when removed from service.

Depreciation

Depreciation of the original cost of generation plant is computed on the straight-line method based on estimated service lives of the various classes of property, which average 75 years. For transmission plant, depreciation of original cost and estimated cost of retirement (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. The net cost of removal (the difference between cost of removal

and salvage value) is included in depreciation rates; however, in the event there is negative salvage (the cost of removal exceeds salvage value), a reclassification of the negative salvage reserve not associated with asset retirement obligations is made from accumulated depreciation to a regulatory liability.

Allowance for funds used during construction

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

FCRPS capitalizes AFUDC at one rate for Corps and Reclamation construction funded by congressional appropriations and at another rate for construction funded substantially by BPA. The rates for appropriated funds are provided each year to BPA by the U.S. Treasury, whereas the BPA rate is determined based on BPA's weighted-average cost of borrowing. The respective rates were approximately 2.0 percent and 5.2 percent in fiscal year 2009, 4.3 percent and 5.4 percent in fiscal year 2008, and 5.1 percent and 5.1 percent in fiscal year 2007.

Nonfederal generation

BPA has acquired all of the generating capability of Energy Northwest's Columbia Generating Station (CGS) nuclear power plant. The contracts to acquire the generating capability of the project require 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 represent intangible assets equal to the related nonfederal debt associated with those generation assets. These intangible assets are amortized as the principal on the outstanding bonds is repaid by the nonfederal entities (see Note 8, Nonfederal Debt).

Cash

For purposes of reporting cash flows, amounts include cash in the BPA fund and unexpended appropriations of the Corps and Reclamation. The BPA fund with the U.S. Treasury consists of the BPA public enterprise fund and the Corps allocation transfer account that may be used to make expenditures without further appropriation and without fiscal year limitation.

U.S. Treasury market-based special securities

In 2009, BPA began participating in the U.S. Treasury's Federal Investment Program. Through this program, the U.S. Treasury provides investment services to federal government entities that have funds on deposit with the U.S. Treasury and have legislative authority to invest those funds. Investments of the funds are generally restricted to special non-marketable securities, also called market-based specials. Under its new banking arrangement with the U.S. Treasury, BPA has agreed to invest at least \$100 million annually for up to 10 years or until the BPA fund is fully invested. U.S. Treasury market-based specials acquired during fiscal year 2009 have maturities of up to five years and weighted-average yield of 2.1 percent. BPA follows the authoritative guidance for Investments for Debt and Equity Securities. Investments are classified as held-to-maturity and reported at amortized cost. Investments with maturities that will be realized in cash within one year are classified as current assets. At Sept. 30, 2009, the amortized cost and fair value of these investments were \$97.6 million and \$99.7 million, respectively.

Concentrations of credit risks

General credit risk

Financial instruments that potentially subject the FCRPS to concentrations of credit risk consist primarily of BPA accounts receivable. Credit risk represents the loss that would be recognized if counterparties fail to perform as contracted.

BPA's accounts receivable are spread across a diverse group of public utilities, investor-owned utilities (IOUs), power marketers, wind generators

and others that are located throughout the Western United States and Canada. The accounts receivable exposure results from BPA providing a wide variety of power products and transmission services. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. During fiscal years 2009, 2008 and 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. In order to further manage credit risk, BPA obtains credit support, such as letters of credit, parental guarantees, cash in the form of prepayment, and deposit or escrow from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly.

Allowance for doubtful accounts

Management reviews accounts receivable on a monthly basis to determine if any receivable will potentially be uncollectible. The allowance for doubtful accounts includes amounts estimated through an evaluation of specific accounts, based upon the best available facts and circumstances of customers that may be unable to meet their financial obligations and a reserve for all other customers based on historical experience.

The largest risk relates to the California power markets that were in turmoil during 2000 to 2001 when they experienced historically high power prices and volatility, along with continued uncertainty related to deregulation. The California Independent System Operator and California Power Exchange were customers with whom BPA had contracts for power and transmission delivery during that period and they have been unable to fully pay BPA for their purchases. BPA has recorded an allowance for doubtful accounts, which in management's best estimate is sufficient to cover potential exposure. Net exposure after the allowance is not significant. BPA has continued to pursue collection of amounts due.

Post-retirement benefits

Federal employees associated with the operation of the FCRPS are participants in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Both federal employers and their employees contribute a percentage of eligible employee compensation toward funding these post-retirement benefit plans. Based on the statutory agency contribution rates, retirement benefit expense under CSRS is equivalent to 7 percent of eligible employee compensation and under FERS is equivalent to 11.2 percent of eligible employee compensation. The legislatively mandated contribution levels for CSRS and FERS do not fully cover the cost to the federal government to provide the plan benefits. Therefore, the programs are considered underfunded (see Note 12, Commitments and Contingencies). Employees also may participate in the Federal Employees Health Benefits Program and/or the Federal Employees' Group Life Insurance Program, which are similarly underfunded. Retirement benefits under the federal retirement systems are payable by the U.S. Treasury.

Derivative instruments

BPA follows the Derivatives and Hedging accounting guidance that requires 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 the Derivatives and Hedging accounting guidance. Purchases and sales of forward electricity contracts are generally considered normal purchases and normal sales if they 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 the Derivatives and Hedging accounting guidance. These transactions are not required to be recorded at fair value in the financial statements. Recognition of these contracts in Sales or Purchased power costs in the Combined Statements of Revenues and Expenses occurs when the contracts settle.

Fair value

BPA's carrying amounts of current assets and current liabilities approximates fair value based on the short-term nature of these instruments. In accordance with authoritative guidance for Fair Value Measurements and Disclosures, BPA uses fair value measurements to record adjustments to certain financial assets and liabilities and to determine fair value disclosures. When developing fair value measurements, it is BPA's policy to use quoted market prices whenever available, or to maximize the use of observable inputs and minimize the use of unobservable inputs when quoted market prices are not available. Fair values are primarily developed using industry standard models that consider various inputs including: (a) quoted forward prices for commodities; (b) time value; (c) volatility factors; (d) current market and contractual prices for underlying instruments; (e) market interest rates and yield curves; and (f) credit spreads, as well as other relevant economic measures (see Note 10, Risk Management and Derivative Instruments and Note 11, Fair Value Measurements).

Revenues and net revenues

Operating revenues are recorded when services are rendered and include estimated unbilled revenues of \$172.8 million, \$203.0 million and \$181.5 million at Sept. 30, 2009, 2008 and 2007, respectively.

Because BPA is a federal government power marketing administration, net revenues over time are committed to repayment of the U.S. government investment in the FCRPS, the payment of certain irrigation costs (see Note 12, Commitments and Contingencies) and the payment of operational obligations, including debt for both operating and nonoperating nonfederal projects.

Interest income

Interest income represents both interest earned on BPA's fund balance with the U.S. Treasury in the form of interest credits and interest earned on investments in market-based special securities. BPA continues to earn interest at the weighted-average interest rate of its outstanding federal borrowings debt based on daily fund balances. Such interest is not received in cash but is applied as a noncash

reduction to monthly debt interest payments to the U.S. Treasury. Under the new banking arrangement with the U.S. Treasury signed in April 2008, BPA began investing in market-based special securities as of Oct. 1, 2008. Interest earnings on investments are dependent on the performance of the market-based special securities and interest earned is a cash receipt.

U.S. Treasury credits for fish

The Pacific Northwest Electric Power Planning and Conservation Act of 1980 obligates the BPA administrator to make expenditures for fish and wildlife protection, mitigation and enhancement for both power and nonpower purposes on a reimbursement basis. The Northwest Power Act also specifies that consumers of electric power, through their rates for power services, “shall bear the costs of measures designed to deal with adverse impacts caused by the development and operation of electric power facilities and programs only.” Section 4(h)(10)(C) of the Northwest Power Act was designed to ensure that the costs of mitigating these impacts are properly accounted for among the various purposes of the hydroelectric projects. As such, BPA reduces its cash payments to the U.S. Treasury by an amount equal to the mitigation measures funded on behalf of the nonpower purposes.

Residential Exchange Program

In order to provide regional utilities, primarily IOUs, access to benefits from the FCRPS, Congress established the Residential Exchange Program (REP) in Section 5(c) of the Northwest Power Act. Whenever a Pacific Northwest electric utility offers to sell power to BPA at the utility’s average system cost (ASC) of resources, BPA purchases such power and offers, in exchange, to sell an equivalent amount of power at BPA’s Priority Firm (PF) Exchange rate to the utility for resale to that utility’s residential and small farm consumers. REP costs are forecast for each year of the rate period and included in the revenue requirement for establishing rates. They are collected in rates with program costs recognized when incurred net of the purchase and sale of power under the REP.

In fiscal year 2008, BPA filed the 2007 Supplemental Wholesale Power Rate Case (WP-07 Supplemental

Rate Case) to resolve outstanding claims and associated judicial rulings related to prior REP billings. In connection with that filing, Lookback Amounts due to and due from BPA customers were identified and recorded as regulatory amounts. Such Lookback Amounts are being collected from identified IOU customers and are being returned to the Consumer-Owned Utilities (COUs) over time. In each succeeding rate case, the BPA administrator designates the amount to be recovered from the IOUs and returned to each qualifying COU. These amounts do not reduce rates, but are reflected as credits to qualifying COUs’ bills as designated in the corresponding Final Record of Decision (ROD). BPA recognizes a refund and reduces expense in the year it is applied, until the Lookback Amount is eliminated. These transactions are net operating revenue neutral as the same amount reduces both revenue and expense (see Note 4, Residential Exchange Program).

RECENT ACCOUNTING PRONOUNCEMENTS

Fair value measurements and disclosures

This standard provides guidance for using fair value to measure assets and liabilities that currently require fair value measurement. It applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. The guidance establishes a fair value hierarchy that prioritizes the information used to develop measurement assumptions and became effective for BPA on Oct. 1, 2008 (see Note 11, Fair Value Measurements). The adoption of this guidance did not materially impact BPA’s financial condition, results of operations or cash flows.

There was additional clarifying guidance issued in fiscal year 2009, related to fair value measurements regarding the exclusion of leasing transactions, deferral of nonfinancial assets and liabilities, observable inputs in active markets which are not available and valuation in inactive markets. The adoption of these new standards did not materially impact BPA’s financial condition, results of operations or cash flows.

Derivatives and hedging

Effective for fiscal year 2009, BPA adopted new accounting standards for derivatives and hedging, which requires enhanced disclosures on derivative instruments and hedging activities. These updates expand the disclosure requirements for derivative instruments and hedging activities. This new guidance is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable financial statement readers to better understand how and why an entity uses derivative instruments and their effects on an entity's financial position, financial performance and cash flows (see Note 10, Risk Management and Derivative Instruments). The adoption of this new standard resulted in increased disclosures only.

Subsequent events

Effective for fiscal year 2009, FCRPS adopted new accounting standards for subsequent events. This standard establishes principles and disclosure requirements for events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. The implementation of this guidance did not materially impact FCRPS' financial condition, results of operations or cash flows.

Generally accepted accounting principles

This standard establishes Accounting Standards Codification as the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles. BPA adopted this standard in fiscal year 2009.

Variable Interest Entity

In June 2009, the Financial Accounting Standards Board issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)." This statement requires an analysis to determine whether BPA's Variable Interest Entities (VIEs) provide BPA with a controlling financial interest in the VIEs. The statement defines the primary beneficiary of the VIE as the entity having power to control the activities that most significantly impact the performance. The

primary beneficiary is also defined as having the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. This guidance will be effective for fiscal year 2011. BPA is evaluating the impact on BPA's financial statements.

SUBSEQUENT EVENTS

FCRPS has performed an evaluation of events and transactions for potential recognition or disclosure through Oct. 30, 2009, which is the date the financial statements were issued.

2. Asset retirement obligations

As of Sept. 30 — thousands of dollars

	2009	2008
Beginning Balance	\$ 159,800	\$ 175,500
Activities:		
Accretion	7,739	7,200
Expenditures	(1,501)	(2,600)
Revisions	(3,095)	(20,300)
Ending Balance	\$ 162,943	\$ 159,800

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

AROs include the following items as of Sept. 30, 2009:

- CGS decommissioning and site restoration of \$120.4 million;
- Trojan decommissioning of \$23.6 million;
- Project Nos. 1 and 4 site restoration of \$15.0 million;
- BPA owned transmission assets of \$3.9 million.

In fiscal years 2009 and 2008, BPA reduced the Trojan decommissioning ARO liability by \$3.5 million and \$19.9 million, respectively, to reflect changes in the settlement of demolition activities, reduction in the estimated annual cash flows related to spent fuel operations and adjustments for other decommissioning activities.

NONFEDERAL NUCLEAR DECOMMISSIONING TRUSTS

BPA 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 the Nuclear Regulatory Commission (NRC) requirements. The NRC requires that this period be no longer than 60 years from the time the plant stops operating. The plant is licensed to operate until the current

operating license termination year of 2024. Trust fund requirements for CGS are based on a NRC decommissioning cost estimate and the license termination date.

The fair value of funds set aside in BPA's decommissioning and sites restoration trust funds totaled \$167.2 million and \$157.7 million at Sept. 30, 2009, and 2008, respectively. The funds are invested in cash equivalents, equity and fixed income funds. BPA's investment securities in the trust are classified as available-for-sale in accordance with accounting guidance related to Investments, Debt and Equity Securities. Payments to the trusts for fiscal years 2009, 2008 and 2007 were approximately \$8.2 million, \$7.3 million and \$6.7 million, respectively.

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

As of Sept. 30 — thousands of dollars

	2009	2008
Terminated nuclear facilities	\$ 3,550,170	\$3,674,815
REP Lookback Amount from IOUs	624,496	679,012
Columbia River Fish Mitigation	413,304	370,332
Conservation measures	165,485	191,300
Fish and wildlife measures	158,221	153,618
Settlements	49,409	46,533
Federal Employees' Compensation Act	34,341	34,478
Spacer damper replacement program	30,436	28,677
Sponsored conservation	25,690	29,555
Terminated hydro facilities	23,780	24,725
Trojan decommissioning and site restoration	23,546	27,544
Capital bond premiums	12,373	13,608
Other	1,095	—
Direct-service industries' benefits	—	173,207
Total Regulatory Assets	\$5,112,346	\$5,447,404

Regulatory assets include the following items:

- “Terminated nuclear facilities” include the nonfederal debt for Energy Northwest Nuclear Project Nos. 1 and 3. These assets are amortized as the principal on the outstanding bonds is repaid (see Note 8, Nonfederal Debt).
- “REP Lookback Amount from IOUs” is the amount recoverable from IOUs in future rate cases that reduces their benefit payments. These costs will be recovered and amortized through future rates over a period as established by the administrator until the Lookback Amount is eliminated (see Note 4, Residential Exchange Program).
- “Columbia River Fish Mitigation” is the cost of research and development for fish bypass facilities funded through appropriations since 1989 in accordance with the Energy and Water Development Appropriations Act of 1989, Public Law 100-371. These costs will be recovered through future rates and amortized as scheduled over 75 years.
- “Conservation measures” consist of the costs of capitalized conservation measures and are amortized over periods from five to 20 years.
- “Fish and wildlife measures” consist of capitalized fish and wildlife projects and are amortized over a period of 15 years.
- “Settlements” reflect costs related to settlement agreements resulting from litigation. These costs will be recovered and amortized through future rates over a period as established by the administrator.
- “Federal Employees’ Compensation Act” reflects the actuarial estimated amount of future payments for current recipients of BPA’s worker compensation benefits.
- “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 Damper Replacement Program. These costs are being amortized over a period of 30 years.
- “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.
- “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).
- “Capital bond premiums” are the deferred losses related to refinanced debt and are amortized over the life of the new debt instruments.
- “Direct-service industries’ (DSI) benefits” were expected DSI payments to be made in the future and included in rates. In fiscal year 2009 the liabilities associated with this program were eliminated as the agreements giving rise to these liabilities were invalidated by the Ninth Circuit Court.

REGULATORY LIABILITIES

As of Sept. 30 — thousands of dollars

	2009	2008
Capitalization adjustment	\$1,731,606	\$1,796,511
REP Lookback Amount to COUs	624,496	679,012
Accumulated plant removal costs	172,925	157,492
CGS decommissioning and sites restoration	33,644	28,877
Other	4,600	3,625
Total Regulatory Liabilities	\$2,567,271	\$2,665,517

Regulatory liabilities include the following items:

- “Capitalization adjustment” is the difference between appropriated debt before and after refinancing per the BPA Refinancing Section of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (Refinancing Act), 16 U.S.C. 838(l). The adjustment is being amortized over the remaining period of repayment so that total FCRPS net interest expense is equal to what it would have been in the absence of the Refinancing Act. Amortization of the capitalization adjustment was \$64.9 million for fiscal years 2009, 2008 and 2007, respectively.
- “REP Lookback Amount to COUs” is the amount previously collected through rates that is owed qualifying consumer-owned utilities and will be credits on their future bills. These costs will be repaid and amortized through future rates over a period as established by the administrator until the Lookback Amount is eliminated (see Note 4, Residential Exchange Program).
- “Accumulated plant removal costs” is the amount previously collected through rates as part of depreciation. These costs will be relieved 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 CGS decommissioning and site restoration as well as Project Nos. 1 and 4 sites.

4. Residential Exchange Program

BACKGROUND

As provided in the Northwest Power Act, beginning in 1981 BPA entered into 20-year Residential Purchase and Sale Agreements (RPSAs) with eligible regional utility customers. The RPSAs implemented the REP.

In 2000, BPA signed Residential Exchange Program Settlement Agreements (“REP settlements” or “settlement agreements”) with the region’s six IOUs under which BPA provided monetary and power benefits as a settlement of residential exchange disputes for the period July 1, 2001, through Sept. 30, 2011. BPA later signed additional agreements and amendments related to the settlement agreements with IOU customers. One such agreement provided for the elimination or deferral of certain IOU benefit payments, while later agreements and amendments provided for minimum and maximum amounts for the IOU monetary benefits for fiscal years 2007 through 2011, provided that BPA would have no obligation to provide power to the IOUs in this period. When future amounts were committed through these agreements, BPA recorded a REP settlement liability for the minimum committed amounts, and a regulatory asset for amounts recoverable in future rates.

LOOKBACK AMOUNT

In May 2007, the Ninth Circuit Court ruled that the REP settlements were inconsistent with the Northwest Power Act and that BPA improperly allocated settlement costs to BPA’s preference rates. In response to that ruling, in fiscal year 2008 BPA reduced the REP settlement agreement liability and regulatory asset to zero and conducted the WP-07 Supplemental Rate Case.

On Sept. 22, 2008, the BPA administrator issued a Final ROD that revised power rates for fiscal year 2009, and determined the amount the COUs were overcharged in prior years. The prior overcharges, which amount to \$746.2 million for fiscal years 2002 through 2006, are labeled the “Lookback Amount” in the Final ROD. This Lookback Amount represents amounts over collected from COUs in prior years’ rates, which also represents the amounts overpaid to the IOUs under the settlement agreements in prior years. As described in the WP-07 Supplemental Rate Case, the BPA administrator designated the amount to be recovered from the IOUs and returned to each qualifying COU. These amounts do not reduce rates, but are applied as credits to qualifying COUs as designated in the corresponding Final RODs. BPA recognizes the refund and reduces expense in the year it is applied. These transactions are net revenue neutral as the same amount reduces both revenue and expense. The Lookback Amount is

recorded as both a regulatory asset, representing amounts to be collected from IOUs in the future in rates, and a regulatory liability, representing amounts to be credited to the COUs in future rates.

After recording the Lookback Amount applied for fiscal year 2008 of \$67.2 million, the Lookback Amount ending balance as of Sept. 30, 2008 was \$679.0 million. In 2009, BPA adjusted both the regulatory liability and regulatory asset by \$83.3 million to reflect the \$70.8 million Lookback Amount applied in fiscal year 2009 as scheduled in the Final ROD and the \$12.5 million Lookback Amount applied for the Avista deemer settlement discussed in the 2009 Deemer Adjustment section. In addition, interest of \$28.8 million was applied to the outstanding balance for an account balance of \$624.5 million as of Sept. 30, 2009.

In response to the Ninth Circuit Court ruling that the REP settlement agreements were inconsistent with the Northwest Power Act, BPA returned to a purchase and sale exchange similar to that in effect prior to the REP settlement agreements.

IOU EXCHANGE BENEFITS

In fiscal year 2008, Interim Agreements were executed to provide certain IOUs with temporary REP benefits for their residential and small farm consumers. These agreements included a provision to true-up the amounts advanced with the actual REP benefits for fiscal year 2008. The true-up amount for the IOUs was \$69.6 million; however, provisions in the agreement provided that true-up payments can not be paid until any subsequent legal challenges to BPA's final ROD, if any, are resolved (see Note 12, Commitments and Contingencies). In 2009, BPA reached a settlement with Avista, described below, over their disputed deemer balance which resulted in the amount due to them for their 2008 benefits changing from zero to \$12.0 million and an increase in the IOU exchange benefits balance to \$81.6 million. After applying interest for fiscal year 2009, this balance has increased to \$83.6 million.

2009 DEEMER ADJUSTMENT

In June 2009, BPA reached a settlement regarding the long-standing dispute with Avista Corporation over the REP deemer account provisions. Deemer balances result when a REP exchanging utility's ASC is below the BPA PF Exchange rate. Rather than resulting in a requirement of the exchanging utility to pay BPA for the exchange, the utility deems its ASC to be equal to the PF Exchange rate. The amount that otherwise would have been owed to BPA is accumulated and offset against future benefits until the deemer account is reduced to zero. Upon elimination of the deemer account balance, the exchanging utility is entitled to receive payment for exchange benefits. The settlement with Avista sets the beginning fiscal year 2002 deemer balance to \$55.0 million, rather than the disputed deemer account balance of \$85.6 million.

As discussed above, as part of the WP-07 Supplemental Rate Case, BPA established reconstructed REP benefits and determined the amounts that IOUs were overpaid under the REP settlement agreements the Ninth Circuit Court held to be unlawful. These overpayments, and whether a utility has a deemer account balance under the new RPSAs, depend in part on what the deemer account balance is assumed to be as of Oct. 1, 2001. With the settled deemer balance at the beginning of fiscal year 2002 being lower than that which was used to calculate the reconstructed REP benefits and deemer account balance, Avista receives exchange benefits sooner than they otherwise would have using the disputed account balance. Under the settlement agreement, the reconstruction of exchange benefits results in Avista being eligible for benefits in fiscal year 2008 rather than in the last quarter of fiscal year 2009.

The accumulated effect of the Avista settlement results in higher REP expenses recorded in fiscal year 2009 of \$20.5 million and lower revenues due to the effect of the Avista Lookback Amount applied of \$12.5 million that is recorded as revenue subject to refund. The total effect is a reduction to Net revenue of \$33.0 million for fiscal year 2009.

5. Deferred charges and other

As of Sept. 30 — thousands of dollars

	2009	2008
Special purpose corporations' trust funds	\$ 157,295	\$ 72,482
Derivative instruments	32,206	40,963
Spectrum Relocation fund	30,595	39,243
Other	10,670	11,670
Energy receivable	4,353	11,687
	\$ 235,119	\$176,045

Deferred charges and other include the following items:

- “Special purpose corporations’ trust funds” are amounts held in separate trust accounts for the construction of transmission assets, debt service payments during the construction period and a fund mainly for future principal and interest debt service payments (see Note 8, Nonfederal Debt).
- “Derivative instruments” represent unrealized gains from the derivative portfolio which includes physical power purchase and sale transactions, power exchange transactions, and power and heat rate option contracts.
- The Commercial Spectrum Enhancement Act created the “Spectrum Relocation fund” to reimburse the costs of replacing radio communication equipment displaced as a result of radio band frequencies no longer available to federal agencies. Amounts received from the U.S. Treasury in connection with the Act are restricted for use in constructing replacement assets.
- “Energy receivable” is energy to be returned to BPA for prior transmission line losses and over delivery.

6. Federal appropriations

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

The Refinancing Act required that the outstanding balance of the FCRPS federal appropriations be reset and assigned market rates of interest prevailing as of Oct. 1, 1996. This resulted in a determination that the principal amount of appropriations should be equal to the present value of the principal and interest that would have been paid to the U.S. Treasury in the absence of the

Refinancing Act, plus \$100 million. Appropriations in the amount of \$6.6 billion were subsequently refinanced for \$4.1 billion. This adjustment was recorded as a capitalization adjustment in regulatory liabilities and is being amortized over the remaining period of repayment.

Prior to the mid-1990s, construction and replacement of Corps and Reclamation generating facilities were financed through federal appropriations to the Corps and Reclamation. Annual appropriations were also made for operation and maintenance costs, to be repaid by BPA to the U.S. Treasury by the end of each fiscal year. As a result of the Energy Policy Act of 1992, in lieu of congressional appropriations, BPA directly funds most operation and maintenance expenses as well as capital efficiency and reliability improvements for Corps and Reclamation generating facilities.

Federal generation and transmission appropriations are repaid to the U.S. Treasury within the weighted-average service lives of the associated investments (maximum 50 years) from the time each facility is placed in service. Federal appropriations may be paid early without penalty.

The weighted-average interest rate was 6.5 percent and 6.6 percent on outstanding appropriations as of Sept. 30, 2009, and 2008, respectively.

MATURING FEDERAL APPROPRIATIONS

As of Sept. 30 — thousands of dollars

2010	\$	3,784
2011		21,232
2012		24,622
2013		18,250
2014		19,198
2015 and thereafter		4,309,103

\$4,396,189

7. Borrowings from U.S. Treasury

BPA is authorized by Congress to issue to the U.S. Treasury and have outstanding at any one time, up to \$7.70 billion of interest-bearing debt with terms and conditions comparable to debt issued by U.S. government corporations in order to finance its capital programs, which include Corps and Reclamation direct-funded capital investments. In February 2009, Section 401 of the American Recovery and Reinvestment Act increased BPA's authority of \$4.45 billion by an additional \$3.25 billion. Of the \$7.70 billion, \$1.25 billion is reserved for conservation and renewable resources.

At Sept. 30, 2009, of the total \$2.13 billion of outstanding bonds, \$677.8 million were conservation and renewable resources investments. The weighted-average interest rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently by BPA. As a result, the fair value of BPA's U.S. Treasury borrowings exceeded the carrying value by approximately \$189.6 million and \$109.6 million, based on discounted future cash flows using agency rates offered by the U.S. Treasury as of Sept. 30, 2009, and 2008, respectively, for similar maturities.

The weighted-average interest rate on outstanding U.S. Treasury borrowings was 5.0 percent and 5.2 percent as of Sept. 30, 2009, and 2008, respectively.

MATURING DEBT

As of Sept. 30 — thousands of dollars

2010	\$	365,000
2011		325,000
2012		265,000
2013		122,800
2014		103,000
2015 through 2039		949,640

\$2,130,440

8. Nonfederal debt

PROJECTS FINANCED WITH NONFEDERAL DEBT

As of Sept. 30 — thousands of dollars

	2009	2008
Terminated nuclear facilities:		
Nuclear Project No. 1	\$ 1,821,165	\$ 1,863,790
Nuclear Project No. 3	1,729,005	1,811,025
Terminated nuclear facilities	3,550,170	3,674,815
Nonfederal generation:		
Columbia Generating Station	2,392,475	2,359,765
Cowlitz Falls	127,770	132,880
Nonfederal generation	2,520,245	2,492,645
Lease financing program	445,049	245,132
Sponsored conservation:		
CARES	16,065	18,345
Tacoma	9,625	11,005
Emerald	—	205
Sponsored conservation	25,690	29,555
Northern Wasco	23,780	24,725
	\$ 6,564,934	\$ 6,466,872

Prior to commercial operations, BPA acquired 100 percent of Energy Northwest's Nuclear Project No. 1 and 70 percent of Nuclear Project No. 3. The contracts require BPA to pay all or part of the projects' annual budgets, including maintenance expense and debt service on bonds issued by nonfederal entities. Nuclear Project No. 1 and Nuclear Project No. 3 were terminated prior to completion.

BPA acquired all of the generating capability of the CGS nuclear generating project (formerly Project No. 2) and Cowlitz Falls hydro project and agreed to pay the maintenance and debt service costs.

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

The underlying debt for these Energy Northwest obligations (comprising terminated nuclear facilities and nonfederal generation) matures through 2024 with interest rates that are primarily fixed between 3.0 percent and 7.1 percent.

The fair value of Energy Northwest debt exceeded recorded value by \$647.0 million and \$36.9 million as of Sept. 30, 2009, and 2008, respectively. The valuations are based on a market input evaluation pricing methodology using a combination of market observable data such as current market trade data, reported bid/ask spreads, and institutional bid information. The weighted-average interest rate was 5.3 percent for the Energy Northwest CGS, Nuclear Project No. 1, and Nuclear Project No. 3 portion of outstanding nonfederal debt as of Sept. 30, 2009.

Under the Lease Financing Program, BPA consolidates four special purpose corporations, collectively referred to as NIFCs, that issue debt to and receive advances from nonfederal sources. Combined, the NIFCs have issued \$119.6 million in bonds and borrowed \$325.5 million on lines of credit with various banks. The bonds bear interest at 5.4 percent per annum and mature in 2034. The lines of credit become due in full at various dates ranging between July 1, 2014, and Jan. 1, 2016. On the accompanying Combined Balance Sheets, the bonds and bank credit facilities are included in Nonfederal debt and the leased assets are included in Utility plant.

The fair value of the combined NIFC bonds and lines of credit exceeded the recorded value by \$2.9 million as of Sept. 30, 2009, and was less than the recorded value by \$32.0 million as of Sept. 30, 2008. The valuations are based on the discounted future cash flows using interest rates for similar debt which could have been issued at Sept. 30, 2009, and 2008, respectively. The weighted-average interest rate was 4.6 percent on the NIFCs' outstanding debt as of Sept. 30, 2009.

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.

The Northern Wasco Hydro Project agreement was terminated by the Settlement and Termination Agreement between BPA and the Northern Wasco PUD on April 25, 1995. The Settlement Agreement requires BPA to pay the trustee annual debt service as required by the Bond Resolution.

Nonfederal debt includes both operating and nonoperating projects. BPA recognizes expenses for these projects based upon total project cash funding requirements, which include debt service and operating and maintenance expenses. BPA recognized operating and maintenance expense for these projects of \$298.0 million, \$248.9 million and \$289.6 million in fiscal years 2009, 2008 and 2007, respectively, which is included in Operations and maintenance in the accompanying Combined

Statements of Revenues and Expenses. Debt service for the projects of \$501.4 million, \$479.5 million and \$343.3 million for fiscal years 2009, 2008 and 2007, respectively, is reflected as Nonfederal projects in the accompanying Combined Statements of Revenues and Expenses.

Nonfederal Debt

MATURING DEBT

As of Sept. 30 — thousands of dollars

2010	\$	319,980
2011		307,070
2012		466,130
2013		561,970
2014		742,166
2015 and thereafter		4,167,618

\$ 6,564,934

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.

9. Deferred credits

As of Sept. 30 — thousands of dollars

	2009	2008
Customer reimbursable projects	\$ 218,351	\$ 209,367
Generation interconnection agreements	208,315	159,100
Third AC Intertie capacity agreements	106,490	107,285
Derivative instruments	42,764	15,486
Fiber optic leasing fees	38,916	42,594
Federal Employees' Compensation Act	34,341	34,478
Settlements	28,500	28,500
Capital leases	17,900	18,461
Other	7,649	9,021
Direct-service industries' benefits	—	173,207
	\$ 703,226	\$ 797,499

Deferred credits include the following items:

- “Customer reimbursable projects” consist of advances received from customers where either the customer or BPA will own the resulting asset. If the customer will own the asset under construction, the revenue is recognized as the expenditures are incurred. If BPA will own the resulting asset, the revenue is recognized over the life of the asset once the corresponding asset is placed in service.
- “Generation interconnection agreements” are generators’ advances held as security for requested new network upgrades and interconnection. These advances accrue interest and will be returned as credits against future transmission service on the new or upgraded lines.
- “Third AC Intertie capacity agreements” reflect unearned revenue from customers related to the Third AC Intertie capacity project. Revenue is being recognized over an estimated 49-year life of the related assets.
- “Derivative instruments” reflect the unrealized fair value loss of the derivative portfolio which includes physical power purchase and sale transactions and interest rate swap transactions.
- “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 an amount due for a settlement agreement resulting from litigation (see Note 12, Commitments and Contingencies).
- “Capital leases” represent BPA’s long-term portion of capital lease liabilities for Goshen-Drummond and Lower Valley-Teton transmission lines.
- “Direct-service industries’ benefits” were expected DSI payments to be made in the future and included in rates. In fiscal year 2009 the liabilities associated with this program were eliminated as the agreements giving rise to these liabilities were invalidated by the Ninth Circuit Court.

10. Risk management and derivative instruments

BPA is exposed to various forms of market risk including commodity price risk, commodity volumetric risk, interest rate risk, credit risk and event risk. Non-performance risk, which includes credit risk, is described in Note 11, Fair Value Measurements. BPA has formalized risk management processes in place to manage agency risks, including the use of derivative instruments. The following describes BPA's exposure to and management of risks.

RISK MANAGEMENT

Due to the operational risk posed by fluctuations in river flows and electric market prices, net revenues that result from underlying surplus or deficit energy positions are inherently uncertain. BPA's Transacting Risk Management Committee has responsibility for the oversight of market risk and determines the transactional risk policy and control environment at BPA. Through simulation and analysis of the hydro supply system, experienced business and risk managers install market price risk measures to capture additional market-related risks, including credit and event risk.

COMMODITY PRICE RISK AND VOLUMETRIC RISK

Primarily due to the variation in the available energy from its hydroelectric generation capacity, BPA enters into short- and long-term forward sales and purchase agreements in the wholesale markets to balance its energy supply and demand. Commodity price risk results from fluctuations in the electric market prices in the Pacific Northwest that affects the value of the energy inventory bought and sold as well as the value of prior purchase and sale contracts. In fiscal year 2009, there was a net surplus and sale of energy above that needed to serve the region's firm load obligations.

BPA measures the market price risk in its portfolio on a daily, weekly and monthly basis employing both parametric calculations and non-parametric Monte Carlo simulations to derive net revenues at

risk, mark-to-market, value at risk, and additional risk metrics as appropriate. These methods provide a consistent measure of risk across the energy market in which BPA buys and sells. The use of these methods requires a number of key assumptions including hydro/price correlations, the selection of a confidence level for expected losses, the holding period for liquidation and the treatment of risks outside standard measures such as sensitivity and scenario testing to determine the impacts of a sudden change in market price, volatility, correlations or hydro inventory. These methods assume hypothetical movements in future market prices and in hydro inventory and provide an estimate of possible net revenues outcomes for BPA's portfolios. In response to market price risk, futures, forwards, swaps and option instruments may be used to mitigate BPA's exposure to price fluctuations.

BPA's principal market activity is for the sale of surplus inventory and power purchases to manage its load/resource balance rather than the purchase and sale of electricity to earn trading revenues. The tests critical to trading organizations (i.e., amount of risk to carry over very short time frames) are considered less important than regular and rigorous analysis of the consequences of a range of hydro supply conditions and prolonged holding periods.

CREDIT RISK

Credit risk relates to the risk of loss that might occur as a result of non-performance by counterparties of their obligations to deliver or take delivery of electricity. BPA's counterparties are generally large and stable and do not represent a significant concentration of credit risk. Credit risk is mitigated at BPA by reviewing counterparties for creditworthiness, establishing credit limits, and monitoring credit exposure on a daily basis. To further manage credit risk, BPA obtains credit support such as letters of credit, parental guarantees, cash in the form of prepayment, and deposit of escrow from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly. BPA uses internally developed, commercially appropriate rating methodologies, credit scoring models, publicly available information and external ratings from major credit rating agencies to determine the public rating equivalent grade of counterparties.

During fiscal year 2009, BPA experienced no significant losses as a result of any customer defaults or bankruptcy filings. At Sept. 30, 2009, BPA had \$35.9 million in credit exposure to purchase and sale contracts taking into account netting rights and BPA's credit exposure, net of collateral, to sub-investment grade counterparties which was less than one percent of total outstanding credit exposures. The agency's top five credit exposures were \$35.2 million, or 98 percent, of the total credit exposure. The majority of this exposure is mark-to-market exposure arising from a term transaction with an "A+" rated municipality with ratemaking authority.

INTEREST RATE RISK

BPA has the ability to issue variable rate debt to the U.S. Treasury; however at Sept. 30, 2009, BPA has no federal variable debt outstanding. BPA is not exposed to substantial risk resulting from changes in interest rates as a result of its backing of the variable rate debt issued by Energy Northwest. All of the \$400 million of Energy Northwest variable rate debt outstanding at Sept. 30, 2009, has been effectively swapped into fixed rate debt as described below in the following Interest Rate Swap Transactions section. 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 \$400 million in bonds issued by Energy Northwest.

DERIVATIVE INSTRUMENTS

BPA follows the Derivatives and Hedging accounting guidance that requires 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.

COMMODITY CONTRACTS

It is BPA's policy to document and apply as appropriate the normal purchase and normal sales exception allowed under Derivatives and Hedging accounting guidance. Purchases and sales of forward electricity contracts are generally considered normal purchases and normal sales if

they 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 the Derivatives and Hedging accounting guidance. These transactions are not required to be recorded at fair value in the financial statements. Recognition of these contracts in Sales or Purchased power in the Combined Statements of Revenues and Expenses occurs when the contracts settle.

For all other derivative transactions, BPA applies Fair Value Measurements and Disclosures accounting guidance and records the changes in fair value under Derivative instruments 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 (see Note 11, Fair Value Measurements).

BPA records realized and unrealized losses in the Combined Statements of Revenues and Expenses related to its derivative portfolio. At Sept. 30, 2009, the commodity contracts totaled 6.1 million MWh (gross basis). In the Combined Statements of Cash Flows, BPA records realized and unrealized gains and losses on commodity contract derivative transactions in the operating section. BPA does not apply hedge accounting.

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 \$199 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 net effect of the two swap transactions essentially replaces variable rate debt with 3.3 percent fixed rate debt. Interest rate swap

expense is included in the cash paid for Nonfederal debt in the Combined Statements of Cash Flows. BPA records unrealized gains and losses on interest

rate swap derivative transactions in the operating section as noncash adjustments to Net revenue in the Combined Statements of Cash Flows.

The following table presents BPA's derivative assets and liabilities measured at fair value.

DERIVATIVE ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

As of Sept. 30 — thousands of dollars

	2009	2008
ASSETS		
Derivative instruments¹		
Commodity contracts	\$ 33,549	\$ 43,709
Total (Gross)	33,549	43,709
less: netting ²	(1,343)	(2,746)
Total (Net)	\$ 32,206	\$ 40,963
LIABILITIES		
Derivative instruments¹		
Commodity contracts	\$ (12,861)	\$ (5,667)
Interest rate swaps	(31,246)	(12,565)
Total (Gross)	(44,107)	(18,232)
less: netting ²	1,343	2,746
Total (Net)	\$(42,764)	\$(15,486)

¹ Derivative instruments assets and liabilities are included in Deferred charges and other and Deferred credits in the Combined Balance Sheets, respectively (see Note 5, Deferred Charges and Other and Note 9, Deferred Credits).

² Netting represents a balance sheet adjustment for same counterparty master netting arrangements.

The following table presents the effect of derivative instruments on the Combined Statements of Revenues and Expenses.

AMOUNT OF GAIN (LOSS) RECOGNIZED

As of Sept. 30 — thousands of dollars

		2009	2008	2007
	Location of Gain (Loss) Recognized in Net Revenues (Expenses)			
Commodity contracts	Derivative instruments	\$ (17,356)	\$ (13,314)	\$ (4,402)
Interest rate swaps	Derivative instruments	(18,680)	(17,221)	(2,239)
	Nonfederal projects	(7,450)	—	—
Total		\$ (43,486)	\$ (30,535)	\$ (6,641)

11. Fair Value Measurements

As described in Note 1, Summary of Significant Accounting Policies, BPA adopted the new Fair Value Measurements and Disclosures accounting guidance for all financial instruments (recurring and nonrecurring) and for all nonfinancial instruments subject to recurring fair value measurement effective Oct. 1, 2008. This accounting guidance defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. This accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. This accounting guidance clarifies that fair value should be based on assumptions that market participants would use when pricing an asset or liability, including assumptions about risk and the risks inherent in valuation techniques and the inputs to valuations. This includes not only the credit standing of counterparties involved and the impact of credit enhancements but also the impact of BPA's own non-performance risk on its liabilities.

The Fair Value Measurements and Disclosures accounting guidance also requires fair value measurements to assume that the transaction occurs in the principal market for the asset or liability (the market with the most volume and activity for the asset or liability from the perspective of the reporting entity), or in the absence of a principal market, the most advantageous market for the asset or liability (the market in which the reporting entity would be able to maximize the amount received or minimize the amount paid). BPA applied fair value measurements to certain assets and liabilities including commodity and interest rate derivative instruments and nuclear decommissioning trust and other investments in accordance with the requirements described above.

In accordance with the Fair Value Measurements and Disclosures accounting guidance, BPA maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

Fair value is based on actively quoted market prices, if available. In the absence of actively quoted market prices, BPA seeks price information from external sources, including broker quotes and industry publications. If pricing information from external sources is not available, BPA uses forward price curves derived from internal models based on perceived pricing relationships to major trading hubs.

The non-exchange-based option contracts are measured at fair value using models or other market accepted methodologies derived from observable market data and unobservable inputs. These models are primarily industry standard models that consider various inputs including: a) quoted forward prices for commodities, b) time value, c) volatility factors, d) current market and contractual prices for underlying instruments and e) market interest rates and yield curves as well as other relevant economic measures.

BPA also utilizes the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value, into three broad levels:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities that BPA has the ability to access at the measurement date. Instruments categorized in Level 1 primarily consist of financial instruments such as fixed income, equity mutual funds and money market funds.

Level 2 – Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Instruments categorized in Level 2 include certain non-exchange traded derivatives, certain agency securities as part of the special purpose corporations' trust funds investments and interest rate swaps.

Level 3 – Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity for the asset or liability. Instruments categorized in Level 3 include long-dated and modeled commodity contracts.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement in its entirety determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

In accordance with the Fair Value Measurements and Disclosures accounting guidance, BPA includes non-performance risk in calculating fair value measurements. This includes a credit risk adjustment based on the credit spreads of BPA's counterparties

when in an unrealized gain position, or on BPA's own credit spread when in an unrealized loss position. BPA's assessment of non-performance risk is generally derived from the credit default swap market and from bond market credit spreads. The impact of the credit risk adjustments for all outstanding derivatives was immaterial to the fair value calculation at Sept. 30, 2009.

The Fair Value Measurements and Disclosures accounting guidance requires fair value measurements to be separately disclosed by level within the fair value hierarchy and requires a separate reconciliation of fair value measurements categorized as Level 3. The following table presents for each hierarchy level BPA's assets and liabilities measured at fair value on a recurring basis, as of Sept. 30, 2009.

Assets and liabilities measured at fair value on a recurring basis

As of Sept. 30 — thousands of dollars

	Level 1	Level 2	Level 3	Netting ²	Total
ASSETS					
Nonfederal nuclear decommissioning trusts	\$ 167,232	\$ —	\$ —	\$ —	\$167,232
Derivative instruments ¹					
Commodity contracts	—	5,359	28,190	(1,343)	32,206
Special purpose corporations' trust funds	24,423	103,500	—	—	127,923
Total	\$191,655	\$108,859	\$28,190	\$ (1,343)	\$327,361
LIABILITIES					
Derivative instruments ¹					
Commodity contracts	\$ —	\$ (12,861)	\$ —	\$ 1,343	\$(11,518)
Interest rate swaps	—	(31,246)	—	—	(31,246)
Total	\$ —	\$(44,107)	\$ —	\$ 1,343	\$(42,764)

¹ Derivative instruments assets and liabilities are included in Deferred charges and other and Deferred credits in the Combined Balance Sheets, respectively (see Note 5, Deferred Charges and Other and Note 9, Deferred Credits). See Note 10, Risk Management and Derivative Instruments for more information related to BPA's risk strategy and use of derivative instruments.

² Netting represents a balance sheet adjustment for same counterparty master netting arrangements.

The following table presents the changes in the assets and liabilities measured at fair value on a recurring basis and included in the Level 3 fair value category for the fiscal year ended Sept. 30, 2009.

Thousands of dollars

COMMODITY CONTRACTS

Balance at Sept. 30, 2008	\$ 38,486
Total realized and unrealized gains (losses) included in Net revenues (expenses) ¹	(10,296)
Purchases, issuance and settlements	—
Transfers in (out) of Level 3	—
Balance at Sept. 30, 2009	\$ 28,190

The amount of total gains (losses) for the fiscal year included in Net revenues (expenses) attributable to the change in unrealized gains (losses) relating to contracts still held at the reporting date¹

\$ (8,966)

¹ Level – 3 category unrealized losses are included in Derivative instruments and realized losses are included in Purchase power in the Combined Statement of Revenues and Expenses for the fiscal year ended Sept. 30, 2009.

12. Commitments and contingencies

FIRM PURCHASE POWER AND COMMITMENTS

As of Sept. 30 — thousands of dollars

2010	\$ 84,566
2011	70,692
2012	83,805
2013	75,898
2014	78,756
2015 and thereafter	602,970
	\$996,687

BPA enters into commitments to sell expected generation for future dates and when BPA forecasts a resource shortage, BPA plans to take necessary steps to cover the shortage, including, if appropriate, commitments to purchase power for future dates.

BPA records expenses associated with these purchases in the periods that power is received.

ENDANGERED SPECIES ACT

The Northwest Power Act directs BPA to protect, mitigate and enhance fish and wildlife resources to the extent they are affected by federal hydroelectric projects on the Columbia River and its tributaries. BPA makes expenditures and incurs other costs for fish and wildlife consistent with the Northwest Power Act and the Pacific Northwest Power and Conservation Council's Columbia River Basin Fish and Wildlife Program.

Additionally, certain fish species under the Endangered Species Act (ESA) are listed as threatened or endangered. BPA is financially responsible for expenditures and other costs arising from conformance with the ESA and certain biological opinions prepared by the National Oceanic and Atmospheric Administration Fisheries Service and the U.S. Fish and Wildlife Service in furtherance of the ESA.

In May 2008 BPA, Corps and Reclamation signed 10-year agreements with four Northwest tribes, the Columbia River Inter-Tribal Fish Commission (CRITFC), the State of Idaho and the State of Montana. The Shoshone-Bannock Tribes signed their agreement on Nov. 7, 2008. These agreements that are collectively referred to as the Columbia Basin Fish Accords (Fish Accords) provide for BPA to fund up to approximately \$994.0 million over 10 years, enabling the tribes and states to continue existing programs and to implement new priority fish projects.

In early 2009, Judge Redden requested the Obama administration to present a position on the Biological Opinion (BiOp). The administration has concluded that with an Adaptive Management Implementation Plan (AMIP), the BiOp is biologically and legally sound. The AMIP enhances the BiOp's existing adaptive management framework by employing a more precautionary approach. This means that if ESA-listed salmon and steelhead runs unexpectedly go into significant decline, then certain specified procedures and actions are ready to address the problem.

On Sept. 16, 2009, BPA, Corps and Reclamation signed an agreement with the State of Washington to provide funds to improve the Columbia River estuary habitat. This agreement adds \$40.5 million to the \$49.5 million the BiOp already dedicates for a total commitment of \$90.0 million for estuary habitat through 2018.

BPA's first new rates, since the BiOp and Fish Accords, went into effect Oct. 1, 2009. These rates include an additional \$103.9 million for funding the new activities identified in the BiOp and Fish Accords. The costs of implementing the BiOp's new contingency actions if fish runs experience a severe decline have not been estimated. The State of Oregon, the Nez Perce Tribe and a coalition of environmental and fishing groups filed a response to the AMIP in the U.S. District Court on Oct. 7, 2009. The government filed a rebuttal on Oct. 23, 2009.

Based on the agreements above, BPA has approximately \$1.1 billion in total commitments.

Irrigation assistance

SCHEDULED DISTRIBUTIONS

As of Sept. 30 — thousands of dollars

2010	\$	—
2011		—
2012		1,182
2013		58,822
2014		52,426
2015 and thereafter		553,791

\$ 666,221

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 \$666.2 million and are scheduled over a maximum of 66 years since the time the irrigation facilities were completed and placed in service. 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 irrigators' ability 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 for which BPA has no obligation to recover these costs.

Additional post-retirement contributions – future contributions

As of Sept. 30 — thousands of dollars

2010	\$ 33,435
2011	33,560
2012	34,486
2013	35,641
2014	37,002

\$ 174,124

All fiscal years are estimates and subject to change.

BPA makes additional annual contributions to the U.S. Treasury in order to ensure that all federal post-retirement benefit programs provided to federal employees associated with the operation of the FCRPS are fully funded and to ensure that such costs are both recovered through rates and properly expensed. The additional contributions are based on employee plan participation and the extent to which the particular plans are underfunded. BPA paid \$32.7 million, \$18.0 million and \$21.1 million to the U.S. Treasury during fiscal years 2009, 2008 and 2007, respectively. BPA records these amounts as expenses during the year in which they are paid.

NUCLEAR INSURANCE

BPA is a member of the Nuclear Electric Insurance Limited (NEIL), 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

\$6.9 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is \$14.4 million. For the Business Interruption and/or Extra Expense Insurance policy, the maximum assessment is \$4.8 million.

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

ENVIRONMENTAL MATTERS

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

LITIGATION

Southern California Edison

Southern California Edison (SCE) filed two separate actions pending in the U.S. Court of Federal Claims against BPA related to a power sales and exchange 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); and 2) BPA's termination of the Sales and Exchange Agreement due to SCE's nonperformance (Termination Claim).

In 2006, BPA and SCE executed an agreement to settle the claims wherein BPA would make a payment of \$28.5 million plus applicable interest to SCE if certain identified conditions were met, including a final resolution of BPA's claims pending in the California refund proceedings and related litigation. BPA has recorded a liability in this amount on the basis that all conditions have been met except the final resolution in the California refund proceedings which management considers probable.

BPA established an offsetting regulatory asset for the liability as the costs will be collected in future rates.

California parties' refund claims

BPA was a party to proceedings at FERC that sought refunds for sales into markets operated by the California Independent System Operator (ISO) and the California Power Exchange (PX) during the California energy crisis of 2000-2001. BPA along with a number of other governmental utilities challenged the Commission's refund authority over governmental utilities. In *BPA v. FERC*, 422 F.3d 908 (9th Cir. 2005) the Court found that governmental utilities, like BPA, were not subject to FERC's statutory refund authority. As a consequence of the Court's decision, three California investor-owned utilities along with the State of California filed breach of contract claims in the United States Court of Federal Claims against BPA. The complaints, filed in March of 2007, alleged that BPA was contractually obligated to pay refunds on transactions where BPA received amounts in excess of mitigated market clearing prices established by FERC. The plaintiffs' contractual breach is premised upon a Commission finding that it retroactively reset the prices under the ISO and PX tariffs when it established these mitigated market clearing prices. BPA has separately appealed to the Ninth Circuit Court the Commission finding that it retroactively reset the tariff prices. The plaintiffs' claims for relief exceed \$300 million.

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.

Currently pending before the Ninth Circuit Court are numerous challenges to the decisions BPA reached in the WP-07 Supplemental Rate Case. The petitioners in these cases challenge, among other issues, BPA's calculation of the Lookback Amounts, BPA's decision to recover the Lookback Amounts and BPA's determination of REP benefits. While it is possible that such challenges could result in changes to BPA's calculation or recovery of the Lookback Amounts, BPA management believes any changes would be resolved through future rates.

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 2009.

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



Report of Independent Auditors



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

In our opinion, the accompanying combined balance sheets and the related combined statements of revenues and expenses, of changes in capitalization and long-term liabilities and of cash flows present fairly, in all material respects, the financial position of the Federal Columbia River Power System (FCRPS) at September 30, 2009, and 2008, and the results of its operations and its cash flows for each of the three years ended September 30, 2009, and the changes in its capitalization and long-term liabilities for each of the two years ended September 30, 2009, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of FCRPS' management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Portland, Oregon
October 30, 2009

Federal Repayment

Revenue requirement study

The revenue requirement study demonstrates repayment of federal investment, and it reflects revenues and costs consistent with BPA's 2007 Final Wholesale Power Rate Proposal in July 2006 for fiscal years 2007 and 2008 (see WP-07-FS-BPA-02) and consistent with BPA's WP-07 Supplemental Proposal filed in September 2008 for fiscal year 2009 (see WP-07-FS-BPA-10), and the 2008 Final Transmission Rate Proposal in April 2007 for fiscal years 2008 through 2009 (see TR-08-FS-BPA-01). The final proposals filed with FERC contain the official amortization schedule for the rate periods.

Repayment demonstration

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

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

Repayment policy

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

1. Pay the cost of operating and maintaining the power system including payments to fully fund post-retirement benefits provided to employees associated with the operation of the FCRPS.
2. Pay the cost of obtaining power through purchase and exchange agreements (nonfederal projects) that BPA is obtaining under capitalized lease-purchase agreements.
3. Pay interest on and repay outstanding U.S. Treasury borrowings to finance transmission system construction, conservation, environmental, direct-funded Corps and Reclamation improvements, and fish and wildlife projects.
4. Pay interest on the unrepaid investment in facilities financed with appropriated funds. (Federal hydroelectric projects all were financed with appropriated funds, as were BPA transmission facilities constructed before 1978.)
5. Pay, with interest, any outstanding deferral of interest expense.
6. Repay the power investment in each federal hydroelectric project with interest within 50 years after the project is placed in service (except for the Chandler project, which has a legislated repayment period of 66 years).
7. Repay each increment of the investment in the BPA transmission system financed with appropriated funds with interest within the average service life of the associated transmission plant (40 years).

8. Repay the appropriated investment in each replacement at a federal hydroelectric project within its service life.
9. Repay irrigation investment at federal reclamation projects assigned for payment from FCRPS power net revenues within the same period established for irrigation water users to repay their share of construction costs. These periods range from 40 to 66 years, with 50 years being applicable to most of the irrigation payment assistance.

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

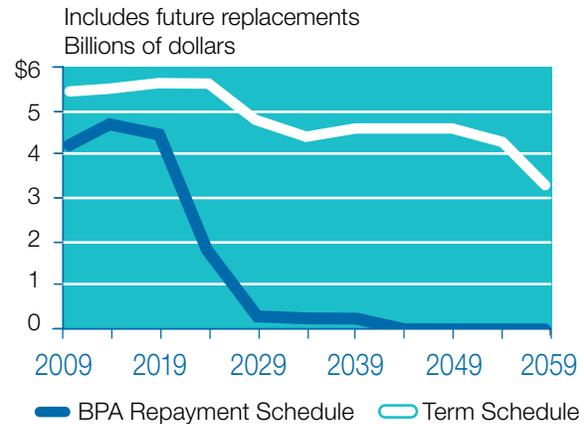
Repayment obligation

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

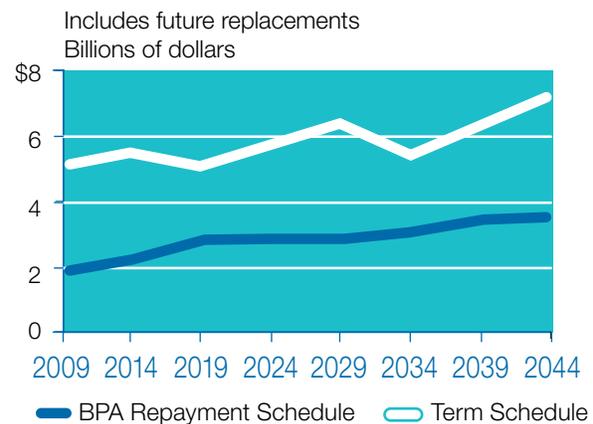
If existing rates are not likely to meet this requirement, BPA must reduce costs, adjust its rates, or both. However, total irrigation assistance payments cannot require an increase in the BPA power rate level. Comparing BPA's repayment schedule for the unrepaid capital appropriations and bonds with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

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

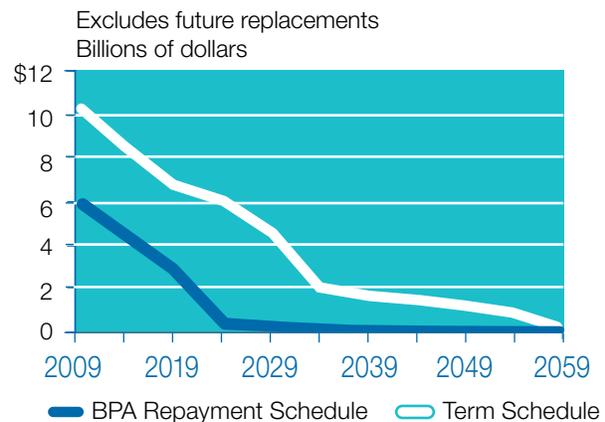
Unrepaid Federal Generation Investment



Unrepaid Federal Transmission Investment



Unrepaid Federal Investment



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 2009 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.



BPA Executives

Stephen J. Wright

Administrator and Chief Executive Officer

Allen L. Burns, acting

Deputy Administrator

Anita J. Decker

Chief Operating Officer

David J. Armstrong

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and Chief Financial Officer

Kimberly A. Leathley

Executive Vice President for
Internal Business Services

Elliot E. Mainzer

Executive Vice President for
Corporate Strategy

Randy A. Roach

Executive Vice President for General Counsel,
and General Counsel

Gregory K. Delwiche

Vice President for Environment,
Fish and Wildlife

Michael J. Weedall

Vice President for Energy Efficiency

Christy Brannon

Chief Public Affairs Officer

Larry D. Buttress

Chief Information Officer

Claudia R. Andrews, acting

Chief Risk Officer

John L. Hairston

Chief Compliance Officer

Terry V. Oliver

Chief Technology Innovation Officer

79

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Senior Vice President for Power Services

Samuel D. Cannady, acting

Vice President for Bulk Marketing

Scott A. Coe, acting

Vice President for Northwest
Requirements Marketing

Stephen R. Oliver

Vice President for Generation Asset Management

Transmission Services

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Senior Vice President for Transmission Services

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Vice President for Engineering and
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Cathy L. Ehli

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