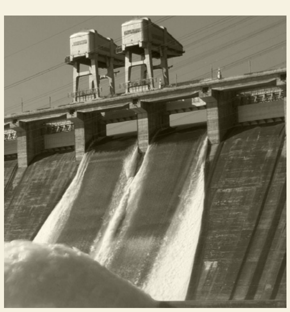
BONNEVILLE POWER ADMINISTRATION

2012 ANNUAL REPORT

AUDITED FINANCIAL STATEMENTS



75 YEARS OF SERVING THE NORTHWEST

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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, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2012, and the changes in its capitalization and long-term liabilities for each of the two years in the period ended September 30, 2012 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the 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

October 26, 2012

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Federal Columbia River Power System
Combined Balance Sheets
As of September 30

(Thousands of Dollars)

	2012	2011
Assets		
Utility plant		
Completed plant	**$ 15,401,287**	$ 14,741,720
Accumulated depreciation	**(5,449,470)**	(5,436,160)
	9,951,817	9,305,560
Construction work in progress	**1,412,134**	1,396,097
Net utility plant	**11,363,951**	10,701,657
Nonfederal generation	**3,318,494**	2,604,078
Current assets		
Cash and cash equivalents	**948,859**	892,125
Short-term investments in U.S. Treasury securities	**242,495**	253,348
Accounts receivable, net of allowance	**86,632**	119,596
Accrued unbilled revenues	**248,769**	207,089
Materials and supplies, at average cost	**99,436**	93,924
Prepaid expenses	**26,060**	29,430
Total current assets	**1,652,251**	1,595,512
Other assets		
Regulatory assets	**7,464,988**	7,812,358
Investments in U.S. Treasury securities	**49,623**	39,129
Nonfederal nuclear decommissioning trusts	**235,598**	198,809
Deferred charges and other	**180,444**	223,736
Total other assets	**7,930,653**	8,274,032
Total assets	**$ 24,265,349**	$ 23,175,279

The accompanying notes are an integral part of these statements.

Federal Columbia River Power System
Combined Balance Sheets
As of September 30

(Thousands of Dollars)

	2012	2011
Capitalization and Liabilities		
Capitalization and long-term liabilities		
Accumulated net revenues	**$ 2,595,940**	$ 2,510,373
Federal appropriations	**4,249,022**	4,324,881
Borrowings from U.S. Treasury	**3,263,040**	2,678,440
Nonfederal debt	**6,370,733**	5,843,046
Total capitalization and long-term liabilities	**16,478,735**	15,356,740
Commitments and contingencies (Note 14)		
Current liabilities		
Federal appropriations	**-**	24,622
Borrowings from U.S. Treasury	**157,800**	265,000
Nonfederal debt	**493,650**	429,545
Accounts payable and other	**554,006**	523,459
Total current liabilities	**1,205,456**	1,242,626
Other liabilities		
Regulatory liabilities	**2,545,370**	2,456,343
IOU exchange benefits	**3,081,053**	3,161,251
Asset retirement obligations	**161,215**	176,212
Deferred credits and other	**793,520**	782,107
Total other liabilities	**6,581,158**	6,575,913
Total capitalization and liabilities	**$ 24,265,349**	$ 23,175,279

The accompanying notes are an integral part of these statements.

Federal Columbia River Power System
Combined Statements of Revenues and Expenses
For the Years Ended September 30

(Thousands of Dollars)

	2012	2011	2010
Operating revenues			
Sales	**$ 3,179,592**	$ 3,134,209	$ 2,851,097
Derivative instruments	**-**	-	14,800
U.S. Treasury credits for fish	**76,983**	85,102	123,090
Miscellaneous revenues	**61,275**	65,463	66,144
Total operating revenues	**3,317,850**	3,284,774	3,055,131
Operating expenses			
Operations and maintenance	**1,796,902**	1,734,306	1,589,171
Purchased power	**143,119**	177,953	381,468
Nonfederal projects	**659,680**	624,972	600,360
Depreciation and amortization	**389,097**	393,502	368,371
Total operating expenses	**2,988,798**	2,930,733	2,939,370
Net operating revenues	**329,052**	354,041	115,761
Interest expense and (income)			
Interest expense	**331,732**	352,904	331,255
Allowance for funds used during construction	**(45,845)**	(42,983)	(32,867)
Interest income	**(43,587)**	(37,562)	(55,046)
Net interest expense	**242,300**	272,359	243,342
Net revenues (expenses)	**86,752**	81,682	(127,581)
Accumulated net revenues at October 1	**2,510,373**	2,428,691	2,556,272
Irrigation assistance	**(1,185)**	-	-
Accumulated net revenues at September 30	**$ 2,595,940**	$ 2,510,373	$ 2,428,691

The accompanying notes are an integral part of these statements.

Federal Columbia River Power System

Combined Statements of Changes in Capitalization and Long-Term Liabilities

Including Current Portions

(Thousands of Dollars)

	Accumulated Net Revenues	Federal Appropriations	Borrowings from U.S. Treasury	Nonfederal Debt	Total
Balance at September 30, 2010	$ 2,428,691	$ 4,259,399	$ 2,513,440	$ 6,321,760	$ 15,523,290
Federal appropriations:					
Increase	-	129,632	-	-	129,632
Decrease	-	(39,528)	-	-	(39,528)
Borrowings from U.S. Treasury:					
Increase	-	-	800,000	-	800,000
Decrease	-	-	(370,000)	-	(370,000)
Nonfederal debt:					
Increase	-	-	-	349,108	349,108
Decrease	-	-	-	(398,277)	(398,277)
Net revenues	81,682	-	-	-	81,682
Balance at September 30, 2011	$ 2,510,373	$ 4,349,503	$ 2,943,440	$ 6,272,591	$ 16,075,907
Federal appropriations:					
Increase	**-**	**104,696**	**-**	**-**	**104,696**
Decrease	**-**	**(205,177)**	**-**	**-**	**(205,177)**
Borrowings from U.S. Treasury:					
Increase	**-**	**-**	**806,000**	**-**	**806,000**
Decrease	**-**	**-**	**(328,600)**	**-**	**(328,600)**
Nonfederal debt:					
Increase	**-**	**-**	**-**	**1,023,045**	**1,023,045**
Decrease	**-**	**-**	**-**	**(431,253)**	**(431,253)**
Net revenues	**86,752**	**-**	**-**	**-**	**86,752**
Irrigation assistance	**(1,185)**	**-**	**-**	**-**	**(1,185)**
Balance at September 30, 2012	**$ 2,595,940**	**$ 4,249,022**	**$ 3,420,840**	**$ 6,864,383**	**$ 17,130,185**

The accompanying notes are an integral part of these statements.

Federal Columbia River Power System
Combined Statements of Cash Flows
For the Years Ended September 30

(Thousands of Dollars)

	2012	2011	2010
Cash provided by and (used for) operating activities			
Net revenues (expenses)	**$ 86,752**	$ 81,682	$ (127,581)
Non-cash items:			
Depreciation and amortization	**389,097**	393,502	368,371
Amortization of nonfederal projects	**390,266**	306,175	270,525
Unrealized (gain) loss on derivative instruments	**-**	-	(14,800)
Changes in:			
Receivables and unbilled revenues	**(7,564)**	(5,112)	(30,109)
Materials and supplies	**(5,512)**	(8,127)	(8,185)
Prepaid expenses	**3,370**	(3,598)	(1,180)
Accounts payable and other	**35,084**	(50,229)	91,915
Regulatory assets and liabilities	**(162,772)**	(209,173)	(164,775)
Other assets and liabilities	**(80,698)**	(68,134)	(13,813)
Net cash provided by operating activities	**648,023**	436,986	370,368
Cash provided by and (used for) investing activities			
Investment in:			
Utility plant, including AFUDC	**(861,754)**	(787,384)	(683,680)
U.S. Treasury securities:			
Purchases	**(635,000)**	(310,000)	(100,000)
Maturities	**638,767**	163,193	44,683
Deposits to nonfederal nuclear decommissioning trusts	**(9,211)**	(9,616)	(8,753)
Special purpose corporations' trust funds:			
Deposits to	**(202,287)**	(106,260)	(4,646)
Receipts from	**231,994**	66,601	39,780
Net cash used for investing activities	**(837,491)**	(983,466)	(712,616)
Cash provided by and (used for) financing activities			
Federal appropriations:			
Proceeds	**104,696**	129,632	86,470
Repayment	**(164,594)**	(39,528)	(204,829)
Borrowings from U.S. Treasury:			
Proceeds	**806,000**	800,000	638,000
Repayment	**(328,600)**	(370,000)	(255,000)
Nonfederal debt:			
Proceeds	**202,289**	201,963	4,646
Extinguished through refinancing	**-**	(90,000)	-
Repayment	**(364,388)**	(308,277)	(270,525)
Customers:			
Advances for construction	**27,634**	59,806	92,786
Reimbursements to customers	**(35,650)**	(23,662)	(27,648)
Irrigation assistance	**(1,185)**	-	-
Net cash provided by financing activities	**246,202**	359,934	63,900
Net increase and (decrease) in cash and cash equivalents	**56,734**	(186,546)	(278,348)
Cash and cash equivalents at beginning of year	**892,125**	1,078,671	1,357,019
Cash and cash equivalents at end of year	**$ 948,859**	$ 892,125	$ 1,078,671
Supplemental disclosures:			
Cash paid for interest, net of amount capitalized	**$ 350,581**	$ 375,755	$ 360,813
Significant noncash investing and financing activities:			
Federal appropriations	**$ (40,583)**	$ -	$ (18,431)
Nonfederal debt increase for Energy Northwest	**$ 782,655**	$ 147,145	$ 22,705
Extinguished through refinancing for Energy Northwest	**$ (66,865)**	$ -	$ -
Other nonfederal	**$ 38,101**	$ -	$ -

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 operations 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 Financing.)

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 separate and distinct entity within the U.S. Department of Energy; Reclamation and U.S. Fish and Wildlife Service are part of the U.S. Department of the Interior; and the Corps is part of the U.S. Department of Defense. U.S. government properties and income are tax exempt.

Use of estimates

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

Rates and regulatory authority

BPA establishes separate power and transmission rates in accordance with several statutory directives. Rates proposed by BPA are subject to an extensive formal hearing 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. 839e(a)(2), and a standard set out by the Energy Policy Act of 1992, 16 U.S.C. 824. Statutory standards include a requirement that rates must be sufficient to ensure 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 are subject to review in the United States Court of Appeals for the Ninth Circuit (Ninth Circuit Court). Petitions seeking such review must be filed within 90 days of the final FERC approval. The Ninth Circuit Court may either confirm or reject a rate proposed by BPA.

In accordance with authoritative guidance for Regulated Operations, certain costs or credits may be included in rates for recovery or refund over a future period and are recorded as regulatory assets or liabilities. (See Note 3, Effects of Regulation.) Regulatory assets or liabilities are amortized over the periods they are included in rates. Amortization is computed using either the straight-line method or is based upon specific amounts included in rates each year. 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 includes generation and transmission assets. Generation assets were $8.17 billion and $7.96 billion at Sept. 30, 2012, and 2011, respectively. Transmission assets were $7.23 billion and $6.78 billion, including assets under capital lease agreements of $127.6 million and $43.9 million, at Sept. 30, 2012, and 2011, respectively. The costs of substantial additions, major replacements and substantial betterments are capitalized. Costs include 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. When BPA retires utility plant, it charges the original cost and any net proceeds from the disposition to accumulated depreciation.

Depreciation

Depreciation of the original cost of generation plant is computed using straight-line methods based on estimated service lives of the various classes of property, which average 75 years. For transmission plant, depreciation of original cost and estimated net cost of removal is computed primarily on the straight-line group life method based on estimated service lives of the various classes of property, which average 48 years. The estimated net cost of removal is included in depreciation. In the event removal costs are expected to exceed salvage proceeds, a reclassification of this negative salvage is made from accumulated depreciation to a regulatory liability. As actual removal costs are incurred, the associated regulatory liability is reduced.

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 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 and the NIFCs. The rates for appropriated funds are provided each year to BPA by the U.S. Treasury, whereas the BPA rate is determined based on the weighted-average cost of borrowing for BPA and the NIFCs. The respective rates for appropriated and BPA funds were approximately 0.1 percent and 4.1 percent in fiscal year 2012, 0.3 percent and 4.4 percent in fiscal year 2011, and 0.4 percent and 4.8 percent in fiscal year 2010. The weighted-average AFUDC rates for fiscal years 2012, 2011 and 2010 approximated the BPA rates for these years.

Nonfederal generation

BPA contracted to acquire all of the generating capability of Energy Northwest's Columbia Generating Station (CGS) nuclear power plant and Lewis County PUD's Cowlitz Falls Hydroelectric Project. The contracts to acquire the generating capability of the facilities require BPA to pay all of the facilities' operating, maintenance and debt service costs. BPA recognizes expenses for these projects based upon total project cash funding requirements. The nonfederal generation assets in the Combined Balance Sheets are amortized over the term of the outstanding debt. (See Note 8, Nonfederal Financing.)

Cash and cash equivalents

Cash amounts include cash in the BPA fund with the U.S. Treasury and unexpended appropriations of the Corps and Reclamation. Cash equivalents represent short-term U.S. Treasury market-based special securities with maturities of 90 days or less at the date of investment. The carrying value of cash and cash equivalents approximates fair value.

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 consumer-owned utilities (COUs), 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 2012, 2011 and 2010, BPA experienced no material 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. BPA closely monitors counterparties for changes in financial condition and regularly updates credit reviews.

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 customer 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 balance is not material to the financial statements.

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.

BPA applies the normal purchases and normal sales exception under the Derivatives and Hedging accounting guidance. 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.

BPA applies Regulated Operations accounting treatment to its derivative instruments that do not qualify for the normal purchases and normal sales exception and are recorded at fair value. As such, unrealized gains or losses associated with these derivative instruments are recorded on the Combined Balance Sheets under Regulatory assets or Regulatory liabilities.

Fair value

BPA's carrying amounts of current assets and current liabilities approximate 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 12, Risk Management and Derivative Instruments and Note 13, Fair Value Measurements.)

Revenues and net revenues

Operating revenues are recorded when power, transmission and related services are rendered and include estimated unbilled revenues. BPA's net revenues over time are committed to payment of operational obligations, including debt for both operating and nonoperating nonfederal projects, repayment of the U.S. government investment in the FCRPS, and the payment of certain irrigation costs.

Interest income

Interest income includes earnings on BPA's fund balance with the U.S. Treasury, on investments in market-based special securities and from other sources. BPA earns interest on cash balances in the fund at the weighted-average interest rate of its outstanding U.S. Treasury borrowings and reduces its monthly debt interest payments by the interest earned. Interest earnings on investments are based on the stated rates of the individual U.S. Treasury market-based special securities.

U.S. Treasury credits for fish

The Northwest Power Act 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. Power related costs are recovered in BPA's rates. Nonpower related costs are recovered as a reduction to BPA's cash payment to the U.S. Treasury and are shown as a component of Operating revenues in the Combined Statements of Revenues and Expenses.

Residential Exchange Program

In order to provide qualifying 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 of resources, BPA purchases such power and offers, in exchange, to sell an equivalent amount of power at BPA's priority firm 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. The cost of this program is collected through rates. Program costs are recognized when incurred net of the purchase and sale of power under the REP.

In fiscal year 2008, BPA conducted the 2007 Supplemental Wholesale Power Rate Case (WP-07 Supplemental Rate Case) to resolve outstanding claims and address associated judicial rulings related to prior REP billings. In 2009, BPA conducted the 2010 Wholesale Power and Transmission Rate Adjustment Proceeding (WP-10 Rate Case), continuing the policies established in WP-07 Supplemental Rate Case. In connection with those filings, Lookback Amounts due to and due from BPA customers were identified and recorded as regulatory amounts. Such Lookback Amounts were collected from identified IOU customers and were being returned to the COUs over time.

In fiscal year 2011, the BPA administrator signed the 2012 Residential Exchange Program Settlement Agreement (Settlement Agreement), resolving disputes related to the REP. The Settlement Agreement provides for fixed "Scheduled Amounts" payable to the IOUs, as well as fixed "Refund Amounts" payable to the COUs. The Settlement Agreement eliminates the Lookback Amounts as of Sept. 30, 2011, and replaces them with the Refund Amounts for amounts overpaid by the COUs. These amounts do not reduce rates but are reflected as credits to qualifying COUs' bills as designated in the Settlement Agreement. BPA utilizes the rates process to reduce the IOUs' benefits and thus reduce the expense in the year it is applied. (See Note 10, Residential Exchange Program.)

RECENT ACCOUNTING PRONOUNCEMENTS

Balance Sheet Offsetting

In December 2011, the FASB issued authoritative guidance that requires an entity to provide quantitative disclosures about offsetting financial instruments and derivative instruments. Additionally, this guidance requires qualitative and quantitative disclosures about master netting agreements or similar agreements when the financial instruments and derivative instruments are not offset. This guidance will be effective for fiscal year 2014. BPA is evaluating the impact of adopting this guidance on its disclosures included within Notes to Financial Statements.

Fair value measurements and disclosures

In January 2010, the FASB issued authoritative guidance related to fair value disclosures. The guidance requires additional detailed disclosure for all levels of fair value measurements. The amounts of significant transfers in and out of Levels 1 and 2 are required to be disclosed, along with the reasons for those transfers. Purchase, issuance and settlement activity in Level 3 is required to be disclosed on a gross basis. Fair value measurement disclosures are required for each class of assets and liabilities. These classes are a matter of management judgment. The guidance further requires disclosures about inputs and valuation techniques used for both Level 2 and Level 3 fair value measurements. BPA adopted this guidance on Oct. 1, 2010, with the exception of that relating to the gross disclosure of purchase, issuance and settlement activity in Level 3, which BPA adopted on Oct. 1, 2011.

In May 2011, the FASB issued authoritative guidance which made a number of incremental changes to current fair value measurement and disclosure guidance. Changes with potential relevance to BPA include the clarification of the concept of “highest and best use” in fair value measurements, guidance on when financial instruments may be recorded on a net basis, and certain additional required disclosures for fair value measurements. This guidance will be effective for fiscal year 2013. BPA is evaluating the impact of adopting this guidance on its disclosures included within Notes to Financial Statements.

SUBSEQUENT EVENTS

FCRPS has performed an evaluation of events and transactions for potential recognition or disclosure through Oct. 26, 2012, which is the date the financial statements were issued.

2. Investments in U.S. Treasury Securities

As of Sept. 30 — thousands of dollars	**2012**		2011	
	Amortized cost	**Fair value**	Amortized cost	Fair value
Short-term	**$ 242,495**	**$ 242,911**	$ 253,348	$ 253,656
Long-term	**49,623**	**49,984**	39,129	40,712
Total	**$ 292,118**	**$ 292,895**	$ 292,477	$ 294,368

BPA participates in the U.S. Treasury’s Federal Investment Program which 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 banking arrangement with the U.S. Treasury, BPA has agreed to invest $100 million annually for up to 10 years or until the BPA fund is fully invested. Any remaining balance in the BPA fund at the 10th year will be invested through the Federal Investment Program.

Market-based specials held during fiscal years 2012 and 2011 had a weighted-average yield of 0.4 percent and 0.8 percent, respectively, and maturities of up to two years. The amounts shown in the table above exclude U.S. Treasury securities with maturities of 90 days or less at the date of investment, which are considered cash equivalents and are included in the Combined Balance Sheets as part of Cash and cash equivalents. For all other securities, BPA follows the authoritative guidance for Investments, Debt and Equity Securities. These 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 short-term investments. Long-term investments have stated maturities between one and two years from the balance sheet date.

3. Effects of Regulation

REGULATORY ASSETS

As of Sept. 30 — thousands of dollars	**2012**	2011
REP Scheduled Amounts	**$ 2,993,310**	$ 3,074,870
Terminated nuclear facilities	**2,606,661**	2,986,393
Columbia River Fish Mitigation	**546,604**	469,783
REP Refund Amounts	**500,155**	565,359
Conservation measures	**297,838**	272,924
Fish and wildlife measures	**278,102**	246,480
Legal claims and settlements	**74,419**	50,428
Derivative instruments	**39,049**	27,422
Spacer damper replacement program	**37,775**	21,853
Federal Employees' Compensation Act	**31,352**	31,352
Trojan decommissioning and site restoration	**23,189**	23,506
Terminated hydro facilities	**18,602**	21,740
Capital bond premiums	**9,810**	10,554
Sponsored conservation	**4,783**	8,615
Other	**3,339**	1,079
Total	**$ 7,464,988**	$ 7,812,358

Regulatory assets include the following items:

"REP Scheduled Amounts" reflect the costs of REP Scheduled Amounts representing REP benefits payable under the 2012 REP Settlement Agreement that will be recovered through rates through 2028. (See Note 10, Residential Exchange Program.)

"Terminated nuclear facilities" consists of the nonfederal debt for Energy Northwest Nuclear Project Nos. 1 and 3. These assets are amortized over the term of the related outstanding debt. (See Note 8, Nonfederal Financing.)

"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 are recovered through rates and amortized as scheduled over 75 years.

"REP Refund Amounts" is the amount recoverable in future rate periods that reduces the REP benefit payments through 2019 as set forth in the 2012 REP Settlement Agreement. (See Note 10, Residential Exchange Program.)

"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.

"Legal claims and settlements" reflect accrued liabilities related to outstanding legal claims and settlement agreements. These costs will be recovered and amortized through future rates over a period as established by the administrator.

"Derivative instruments" reflect the unrealized losses from BPA's derivative portfolio. (See Note 12, Risk Management and Derivative Instruments.) These amounts are deferred over the corresponding underlying contract delivery months.

"Spacer damper replacement program" consists of costs to replace deteriorated spacer dampers and are being recovered in rates under the Spacer Damper Replacement Program. These costs are being amortized over a period of 25 or 30 years. In fiscal year 2011, BPA recognized an impairment charge of $20.6 million in deferred spacer damper replacement program costs.

"Federal Employees' Compensation Act" reflects the actuarial estimated amount of future payments for current recipients of BPA's worker compensation benefits.

"Trojan decommissioning and site restoration" costs reflect the amount to be recovered in future rates for funding the Trojan asset retirement obligation (ARO) liability. (See Note 4, Asset Retirement Obligations.)

"Terminated hydro facilities" consists of the nonfederal debt for the terminated Northern Wasco hydro project. These assets are amortized over the term of the related outstanding debt. (See Note 8, Nonfederal Financing.)

"Capital bond premiums" are losses related to refinanced U.S. Treasury debt and are amortized over the life of the new debt instruments.

"Sponsored conservation" consists of the nonfederal debt for Conservation and Renewable Energy System (CARES) and City of Tacoma Conservation bonds. This debt was issued to finance conservation programs sponsored by BPA. The assets are amortized over the term of the related outstanding debt.

REGULATORY LIABILITIES

As of Sept. 30 — thousands of dollars	**2012**	2011
Capitalization adjustment	**$ 1,536,891**	$ 1,601,796
REP Refund Amounts to COUs	**500,155**	565,359
Accumulated plant removal costs	**390,622**	201,266
CGS decommissioning and site restoration	**99,182**	51,409
Derivative instruments	**12,141**	30,924
Other	**6,379**	5,589
Total	**$ 2,545,370**	$ 2,456,343

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 2012, 2011 and 2010, respectively. (See Note 6, Federal Appropriations.)

"REP Refund Amounts to COUs" is the amount previously collected through rates that is owed to 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 in the 2012 REP Settlement Agreement. (See Note 10, Residential Exchange Program.)

"Accumulated plant removal costs" are the amounts previously collected through rates as part of depreciation. The liability will be relieved as actual removal costs are paid. In fiscal year 2012, collections associated with estimated removal costs in prior years of $178.8 million were reclassified from accumulated depreciation to this regulatory liability. This adjustment was not considered material to previously issued financial statements.

"CGS decommissioning and site 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.

"Derivative instruments" reflect the unrealized gains from BPA's derivative instruments that are marked-to-market in accordance with current authoritative derivative accounting guidance. (See Note 12, Risk Management and Derivative Instruments.) These amounts are deferred over the corresponding underlying contract delivery months.

4. Asset Retirement Obligations

As of Sept. 30 — thousands of dollars	**2012**	2011
Beginning Balance	**$ 176,212**	$ 170,334
Activities:		
Accretion	**8,305**	8,640
Expenditures	**(1,269)**	(2,234)
Revisions	**(22,033)**	(528)
Ending Balance	**$ 161,215**	$ 176,212

BPA recognizes AROs according to the estimated fair value of the dismantlement and restoration costs associated with the retirement of certain tangible long lived assets. The liability is adjusted for any revisions, expenditures and the passage of time. During fiscal year 2012, the ARO for CGS decreased by $22.0 million primarily due to a revised cost estimate following relicensing of the facility for an additional 20 years. FCRPS also has tangible long-lived assets such as federal hydro projects and transmission assets without an associated ARO since no future obligation exists to remove these assets.

AROs include the following items as of Sept. 30, 2012:

- CGS decommissioning and site restoration of $121.4 million;
- Trojan decommissioning of $23.2 million;
- Energy Northwest Project Nos. 1 and 4 site restoration of $16.6 million.

NONFEDERAL NUCLEAR DECOMMISSIONING TRUSTS

As of Sept. 30 — thousands of dollars	**2012**		2011	
	Amortized cost	**Fair value**	Amortized cost	Fair value
Equity index funds	**$ 84,377**	**$ 100,050**	$ 77,097	$ 74,923
U.S. government obligation mutual funds	**72,200**	**74,067**	84,050	86,834
Corporate bond index funds	**57,150**	**61,460**	36,834	37,028
Cash and cash equivalents	**21**	**21**	24	24
Total	**$ 213,748**	**$ 235,598**	$ 198,005	$ 198,809

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. External trust funds for decommissioning and site restoration costs are 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. In May 2012, the NRC renewed CGS's operating license for an additional 20 years and the license now expires in 2043. Trust fund requirements for CGS are based on an NRC decommissioning cost estimate and the license termination date. The trusts are funded and managed by BPA in accordance with the NRC requirements and site certification agreements.

The investment securities in the decommissioning and site restoration trust accounts are classified by BPA as available-for-sale in accordance with accounting guidance related to Investments, Debt and Equity Securities. BPA recognizes the unrealized gains and losses on these investment securities as adjustments to the related regulatory liability, which represents the excess of the amount previously collected through rates over the current ARO balance. (See Note 3, Effects of Regulation.) Payments to the trusts for fiscal years 2012, 2011 and 2010 were approximately $9.2 million, $9.6 million and $8.8 million, respectively.

Based on an agreement in place, 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.

5. Deferred Charges and Other

As of Sept. 30 — thousands of dollars	**2012**	2011
Special purpose corporations' trust funds	**$ 121,032**	$ 155,301
Settlements receivable	**16,000**	-
Derivative instruments	**12,141**	32,380
Spectrum Relocation fund	**9,608**	15,884
Funding agreements	**7,174**	-
Trust fund and other deposits	**6,290**	11,341
Energy receivable	**4,768**	5,334
Other	**3,431**	3,496
Total	**$ 180,444**	$ 223,736

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 Financing.)

"Settlements receivable" represents interest earned by BPA on certain settlements, the principal of which has been collected. The timing of cash receipt of the interest is unknown.

"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.

"Spectrum Relocation fund" was created 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 Commercial Spectrum Enhancement Act are held in the BPA fund and are restricted for use in constructing replacement assets.

"Funding agreements" represents deferred costs associated with BPA's contractual obligations to determine the feasibility of certain joint transmission projects.

"Trust fund and other deposits" primarily represent funds held in the Conservation and Renewable Energy System (CARES) defeasance trust fund.

"Energy receivable" primarily consists of energy to be returned to BPA for prior transmission line losses.

6. Federal Appropriations

Appropriations consist primarily of the power portion of Corps and Reclamation capital investments 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).

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 $6.69 billion were subsequently refinanced for $4.10 billion. This adjustment was recorded as a capitalization adjustment in regulatory liabilities and is being amortized over the remaining period of repayment. (See Note 3, Effects of Regulation.)

Federal generation and transmission appropriations are repaid to the U.S. Treasury within the weighted-average service lives of the associated investments from the time each facility was placed in service, with a maximum of 50 years. Federal appropriations may be paid early without penalty. In fiscal year 2012, BPA paid maturing federal appropriations for fiscal years 2012 through 2017. All outstanding federal appropriations are due 2018 and thereafter.

The weighted-average interest rate was 6.2 percent and 6.3 percent on outstanding appropriations as of Sept. 30, 2012, and 2011, respectively.

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. The debt may be issued to finance BPA’s capital programs, which include Corps and Reclamation direct funded capital investments. Of the $7.70 billion, $750 million can be issued to finance Northwest Power Act related expenses and $1.25 billion is restricted for conservation and renewable resources.

At Sept. 30, 2012, of the total $3.42 billion of outstanding bonds, none related to NW Power Act expenses and $367.8 million were for conservation and renewable resources investments. At Sept. 30, 2012, $300.0 million of outstanding bonds carried a variable rate of interest. There were no outstanding bonds with variable rates of interest at Sept. 30, 2011. The weighted-average interest rate of BPA’s borrowings from the U.S. Treasury exceeds current rates. As a result, the fair value of BPA’s U.S. Treasury borrowings exceeded the carrying value by approximately $484.8 million and $462.6 million, based on discounted future cash flows using agency rates offered by the U.S. Treasury as of Sept. 30, 2012, and 2011, respectively, for similar maturities.

The weighted-average interest rate on outstanding U.S. Treasury borrowings was 3.6 percent and 4.2 percent as of Sept. 30, 2012, and 2011, respectively. At Sept. 30, 2012, the outstanding bonds with a variable rate of interest carried an interest rate of 0.2 percent.

U.S. Treasury borrowings are callable by BPA at a premium or discount, which is calculated based on the current government agency rates for the remaining term to maturity at the time the bond is called.

MATURING BORROWINGS FROM U.S. TREASURY

As of Sept. 30 — thousands of dollars	
2013	$ 157,800
2014	103,000
2015	210,000
2016	30,000
2017	36,400
2018 through 2042	2,883,640
Total	**$ 3,420,840**

8. Nonfederal Financing

PROJECTS FINANCED WITH NONFEDERAL DEBT

As of Sept. 30 — thousands of dollars	**2012**	2011
Nonfederal generation:		
Columbia Generating Station	**$ 3,224,040**	$ 2,487,355
Cowlitz Falls	**104,650**	116,780
Nonfederal generation	**3,328,690**	2,604,135
Terminated nuclear facilities:		
Nuclear Project No. 1	**1,321,060**	1,573,805
Nuclear Project No. 3	**1,395,405**	1,495,480
Terminated nuclear facilities	**2,716,465**	3,069,285
Lease financing program	**668,054**	559,556
Capital leases	**120,449**	-
Sponsored conservation:		
Conservation and Renewable Energy System	**5,870**	11,200
Tacoma	**5,120**	6,675
Sponsored conservation	**10,990**	17,875
Terminated Northern Wasco Hydro Project	**19,735**	21,740
Total	**$ 6,864,383**	$ 6,272,591

Nonfederal generation and terminated nuclear facilities

BPA contracted to acquire all of the generating capability of Energy Northwest's Columbia Generating Station and Lewis County PUD's Cowlitz Falls Hydroelectric Project. These contracts require that BPA pay all of the operating, maintenance and debt service costs for these projects. BPA also contracted to acquire all of the generating capacity of Energy Northwest's Nuclear Project No. 1 and 70 percent of Energy Northwest's Nuclear Project No. 3; however, these projects were terminated prior to completion. Although not in operation, BPA is required by these contracts to pay debt service costs for these projects.

BPA recognizes expenses for these projects based on total project cash funding requirements, which include debt service and operating and maintenance expenses. BPA recognized operating and maintenance expense for these projects of $298.3 million, $328.1 million and $262.6 million in fiscal years 2012, 2011 and 2010, respectively, which is included in Operations and maintenance expense in the accompanying Combined Statements of Revenues and Expenses. Debt service for the projects of $659.7 million, $625.0 million and $600.4 million for fiscal years 2012, 2011 and 2010, respectively, is reported as Nonfederal projects in the accompanying Combined Statements of Revenues and Expenses.

Related assets for operating projects are included in Nonfederal generation. Related assets for terminated nuclear facilities are included in Regulatory assets. (See Note 3, Effects of Regulation.)

The underlying debt for the Energy Northwest obligations (including terminated nuclear facilities and CGS) currently matures through 2044 with interest rates that are fixed between 1.1 percent and 7.1 percent. Energy Northwest debt of $1.24 billion is callable, in whole or in part, at Energy Northwest's option, on call dates between July 2013 and July 2022 at 100 percent of the principal amount.

The fair value of Energy Northwest debt exceeded recorded value by $824.2 million and $672.7 million as of Sept. 30, 2012, and 2011, 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 4.6 percent and 5.1 percent for the Energy Northwest outstanding nonfederal debt as of Sept. 30, 2012, and 2011, respectively.

Lease financing program

Under the Lease Financing Program, BPA consolidates six special purpose corporations, collectively referred to as Northwest Infrastructure Financing Corporations (NIFCs), which issue debt to and receive advances from nonfederal sources. The combined NIFCs have issued $119.6 million in bonds and borrowed $548.5 million on lines of credit with various banks as of Sept. 30, 2012. The bonds bear interest at 5.4 percent per annum and mature in 2034. All NIFC bonds outstanding are subject to redemption by the issuing NIFC, in whole or in part, at any date, at the higher of the principal amount of the bonds or the present value of the bonds discounted using the U.S. Treasury rate plus a premium of 12.5 basis points. The lines of credit become due in full at various dates ranging between Jan. 1, 2015, and Jan. 1, 2019.

On the accompanying Combined Balance Sheets, the bonds and bank line of credit facilities are included in Nonfederal debt. The leased assets are primarily included in Utility plant and also in Deferred charges and other for unspent funds.

In July 2012, NIFC II sold its lease receivable, rights to future lease revenue, and title to the leased assets to the Port of Morrow, a port district located in Morrow County, Oregon. As the Port of Morrow is not consolidated in the combined FCRPS financial statements, the lease is reported as a capital lease included in Nonfederal debt. The net effect of this transaction is a decrease in Nonfederal debt of $12.4 million and a gain of $1.9 million.

The fair value of the combined NIFC bonds and lines of credit exceeded the recorded value by $45.5 million and $45.0 million as of Sept. 30, 2012, and Sept. 30, 2011, respectively. The valuations are based on the discounted future cash flows using interest rates for similar debt that could have been issued at Sept. 30, 2012, and 2011, respectively. The weighted-average interest rate on the NIFCs' outstanding debt was 3.6 percent and 4.0 percent as of Sept. 30, 2012, and Sept. 30, 2011, respectively.

Capital leases

Capital leases include BPA's lease agreement with the Port of Morrow for $84.7 million and other capital lease liabilities totaling $35.7 million. In prior years the capital leases were reported under Deferred credits and other, and at the end of fiscal year 2011 total capital leases were $36.8 million.

The capital leases expire on various dates through 2044 and are for transmission facilities and equipment, such as transmission lines and substation equipment. Certain capital lease agreements contain provisions that allow

BPA to purchase the leased assets for a nominal fee or transfer ownership of the leased assets to BPA at the end of the lease term.

Sponsored conservation and terminated hydro

BPA has agreed to fund debt service on Conservation and Renewable Energy System (CARES) and City of Tacoma Conservation bonds issued to finance conservation programs sponsored by BPA. BPA is also required by The Settlement and Termination Agreement between BPA and the Northern Wasco PUD to pay annual debt service on the terminated Northern Wasco Hydro Project.

MATURING NONFEDERAL DEBT

As of Sept. 30 — thousands of dollars	
2013	$ 492,370
2014	585,735
2015	791,431
2016	809,107
2017	584,195
2018 and thereafter	3,481,096
Total	**$ 6,743,934**

FUTURE MINIMUM LEASE PAYMENTS UNDER CAPITAL LEASES[1]

As of Sept. 30 — thousands of dollars	
2013	$ 8,122
2014	8,029
2015	8,029
2016	8,030
2017	8,030
2018 and thereafter	249,722
Total undiscounted payments	$ 289,962
Less: Executory costs	(33,402)
Less: Amount representing interest	(136,111)
Present value of minimum lease payments	**120,449**
Less: Current portion	(1,280)
Long-term capital lease liability	$ 119,169

[1] Initial or remaining noncancelable lease terms in excess of one year.

9. Variable Interest Entities

A VIE is an entity that does not have sufficient equity at risk to finance its activities without additional financial support or whose equity investors lack characteristics of a controlling financial interest. An enterprise that has a controlling interest is known as the VIE’s primary beneficiary and is required to consolidate the VIE.

BPA reviews executed power purchase agreements with counterparties that may be considered VIEs. These VIEs are typically legal entities structured to own and operate specific generating facilities, primarily wind farms. Because of their pricing arrangements, these agreements may provide that BPA absorb commodity price risk of the counterparty entities. BPA does not provide, and does not plan to provide, any additional financial support to these entities beyond what BPA is contractually obligated to pay. BPA has concluded that it does not control the operating and maintenance activities that most significantly impact these entities. Therefore, BPA is not considered the primary beneficiary of these VIEs and does not consolidate any entities because of power purchase agreements.

BPA is the primary beneficiary of the NIFCs, which are considered VIEs, and BPA therefore consolidates these entities into the FCRPS financial statements. The key factor in this determination is BPA's ability to direct the commercial and operating activities of the transmission facilities underlying the lease agreements. Additionally, BPA's lease agreements with the NIFC entities obligate BPA to absorb the operational and commercial risks, and thus potentially significant benefits or losses, associated with the underlying transmission facilities. Under the lease purchase agreements, the NIFCs issue debt to finance the construction of the transmission facilities which are then leased to BPA. The collateral for the debt is the lease payment stream from BPA. The NIFC entities hold legal title to the transmission facilities during the lease term, and BPA serves as the construction agent for these leased assets. BPA also has exclusive use and control of the assets during the lease periods and has indemnified the equity owners of the NIFCs for all construction and operating risks associated with the leased transmission facilities. At the end of each lease term, BPA has the option to buy the transmission facilities at a bargain purchase price. BPA provides certain administrative services as construction agent to the NIFCs and is obligated to indemnify certain expenses of the NIFCs related to their respective projects.

Amounts related to the NIFC entities include Deferred charges and other assets of $32.3 million and $33.5 million and Nonfederal debt of $668.1 million and $559.6 million as of Sept. 30, 2012, and 2011, respectively. In July 2012, NIFC II recorded a gain of $1.9 million on the sale of a lease.

10. Residential Exchange Program

BACKGROUND

As provided in the Pacific Northwest Electric Power Planning and Conservation Act (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 with IOU customers related to the settlement agreements. 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 2007 Supplemental Wholesale Power Rate Case (WP-07 Supplemental Rate Case).

On Sept. 22, 2008, the BPA administrator issued a Final Record of Decision (ROD) that revised power rates for fiscal year 2009 and determined the amount the COUs were overcharged in prior years. A portion of the prior overcharges, which amounted to $746.2 million for fiscal years 2002 through 2006, were labeled the “Lookback Amount” in the Final ROD. This Lookback Amount represented amounts over-collected from COUs in prior years’ rates, which also represented the amounts overpaid to the IOUs under the settlement agreements in prior years. As described in the WP-07 Supplemental Rate Case and in the 2010 Wholesale Power and Transmission Rate Adjustment Proceeding (WP-10 Rate Case), the BPA administrator designated the amount to be recovered from each IOU and returned to the qualifying COUs. These amounts did not reduce rates, but were applied as credits to qualifying COUs as designated in the corresponding Final RODs. BPA recognized the refund and reduced expense in the year it was applied. These transactions were net revenue neutral as the same amount reduced both revenue and expense. The Lookback Amount was recorded as both a regulatory asset, representing amounts to be collected from IOUs through future rate proceedings, and a regulatory liability, representing amounts to be credited to the COUs in future rates.

After recording the Lookback Amount for fiscal year 2010 of $82.1 million, the Lookback Amount ending balance including interest as of Sept. 30, 2010, was $568.5 million. In 2011, BPA adjusted both the Regulatory liability and Regulatory asset to $565.4 million to reflect the changes resulting from the 2012 Settlement Agreement. (See Note 3, Effects of Regulation.)

2008 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 could not be paid until any subsequent legal challenges to BPA’s final ROD, if any, are resolved. (See Note 14, Commitments and Contingencies.) As yet, all legal challenges related to this program have not been resolved.

In 2009, BPA reached a settlement with Avista over its disputed deemer balance, which resulted in the amount due to it for its 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 2012, this balance has increased to $87.7 million and is reported as part of the IOU exchange benefits liability of $3.08 billion as of Sept. 30, 2012.

2012 RESIDENTIAL EXCHANGE PROGRAM SETTLEMENT AGREEMENT

Beginning in April 2010, over 50 litigants and other regional parties entered into mediation to resolve their numerous disputes over the REP. Participants reached an agreement in principle in early September 2010 and in February 2011 reached a final settlement agreement – the 2012 Residential Exchange Program Settlement Agreement (Settlement Agreement). In March 2011, BPA distributed the Settlement Agreement for regional entities’ consideration and signature. In conjunction with the customers’ settlement agreement efforts, in December 2010 BPA initiated the Residential Exchange Program Settlement Agreement Proceeding (REP-12) to evaluate the Settlement Agreement and determine whether it was in the region’s best interest for the BPA administrator to sign the Settlement Agreement on behalf of BPA. In July 2011, the BPA administrator signed the REP-12 Final ROD and the Settlement Agreement.

In 2011, BPA recorded a long-term IOU exchange benefits liability and corresponding Regulatory asset of $3.07 billion associated with the Settlement Agreement. Beginning in fiscal year 2012, under the provisions of the Settlement Agreement the IOUs began to receive Scheduled Amounts starting at $182.1 million annually with increases over time to $286.1 million as the final payment in fiscal year 2028. The distribution of these payments will depend on each IOUs’ average system cost and exchange load, plus adjustments to reflect Lookback Amounts recovered from IOUs in fiscal years 2009 through 2011. The settled Scheduled Amounts to be paid to the IOUs total $4.07 billion over the 17-year period. Amounts recorded of $2.99 billion at Sept. 30, 2012, represent the present value of future cash outflows for these exchange benefits.

In addition to Scheduled Amounts, the Settlement Agreement calls for Refund Amounts to be paid of $76.5 million each year beginning in fiscal year 2012 through fiscal year 2019. The Refund Amounts replace the Lookback Amounts and are accounted for similar to the Lookback Amounts in that a regulatory asset and liability have been established for the refunds that will be provided to BPA customers as credits on customer monthly bills. The Settlement Agreement replaces the Lookback Amounts that were reduced to zero as of Sept. 30, 2011, with the Refund Amounts totaling $612.3 million. Amounts recorded as a Regulatory liability of $500.1 million at Sept. 30, 2012, represent the present value of future cash flows for the amounts to be refunded to customers, as well as reduced exchange benefits. The distribution of the Refund Amount will be split between customers with 50 percent of the Refund Amounts ($38.3 million per year) returned to COUs based on the percentages BPA established in the WP-10 Rate Case. The remaining 50 percent will be returned to COUs based on each customer's expected share of Tier 1 load as defined in BPA's 2012 Wholesale Power and Transmission Rate Adjustment Proceeding (BP-12 Rate Case).

11. Deferred Credits and Other

As of Sept. 30 — thousands of dollars	**2012**	2011
Generation interconnection agreements	**$ 271,714**	$ 279,048
Customer reimbursable projects	**232,516**	238,317
Third AC Intertie capacity agreements	**99,231**	101,221
Legal claims and settlements	**80,904**	28,500
Derivative instruments	**39,049**	27,422
Fiber optic leasing fees	**32,599**	32,722
Federal Employees' Compensation Act	**31,352**	31,352
Other	**6,155**	7,906
Capital leases	**-**	35,619
Total	**$ 793,520**	$ 782,107

Deferred credits and other include the following items:

"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 cash or credits against future transmission service on the new or upgraded lines.

"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.

"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.

"Legal claims and settlements" reflect amounts accrued for outstanding legal claims and settlements. (See Note 14, Commitments and Contingencies.)

"Derivative instruments" reflect the unrealized loss of the derivative portfolio which includes physical power purchase and sale transactions and a heat rate option contract.

"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 through 2024.

"Federal Employees' Compensation Act" reflects the actuarial estimated amount of future payments for current recipients of BPA's worker compensation benefits.

"Capital leases" represent BPA's long-term portion of capital lease liabilities that are not part of the Lease Financing Program. During fiscal year 2012, BPA began reporting all capital lease liabilities as a component of Nonfederal debt. (See Note 8, Nonfederal Financing.)

12. 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 13, 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

BPA has exposure to commodity price risk through fluctuations in electric market prices that affect the value of energy bought and sold. Volumetric risk is the uncertainty of energy production from the hydro system. The combination of the two results in net revenue uncertainty. BPA routinely models commodity price risk and volumetric risk through parametric calculations, Monte Carlo simulations and general market observations to derive net revenues at risk, mark-to-market valuations, value at risk and other metrics as appropriate. These metrics capture the uncertainty around single point forecasts in order to monitor changes in the revenue risk profile from changes in market price, market price volatility and forecasted hydro generation. BPA measures and monitors the output of these methods on a regular basis. In order to mitigate revenue uncertainty that is beyond the agency's risk tolerance, BPA enters into short-term and long-term purchase and sale contracts by using instruments such as forwards, swaps, and options.

CREDIT RISK

Credit risk relates to the loss that might occur as a result of counterparty non-performance. 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/or deposit of escrow from some counterparties. Counterparties are monitored closely for changes in financial condition and credit reviews are updated regularly. BPA uses methodologies, scoring models, publicly available financial information and external ratings from major credit rating agencies to determine appropriate levels of credit for its counterparties.

During fiscal year 2012, BPA experienced no material losses as a result of any customer defaults or bankruptcy filings. At Sept. 30, 2012, BPA had $32.6 million in credit exposure to purchase and sale contracts taking into account netting rights. BPA's credit exposure, net of cash collateral, to sub-investment grade counterparties was less than one percent of total outstanding credit exposures. BPA's top five credit exposures were $21.0 million, or 64.5 percent, of the total credit exposure.

INTEREST RATE RISK

BPA has the ability to issue variable rate debt to the U.S. Treasury. As of Sept. 30, 2012, BPA had $300.0 million in outstanding variable rate U.S. Treasury debt at an average interest rate of 0.2 percent. BPA manages the interest rate risk presented by variable rate U.S. Treasury debt by holding an identical amount of variable rate U.S. Treasury security investments with a similar maturity profile. These U.S. Treasury investments earn interest at a variable rate that is correlated, but not identical, to the interest rate paid on U.S. Treasury variable rate debt. (See Note 2, Investments in U.S. Treasury Securities and Note 7, Borrowings from 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.

COMMODITY CONTRACTS

It is BPA's policy to document and apply as appropriate the normal purchases and normal sales exception allowed under Derivatives and Hedging accounting guidance. 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.

In fiscal year 2010, BPA began applying Regulated Operations accounting treatment to its derivative instruments that are recorded at fair value and do not meet the normal purchases and normal sales exception. As a result, BPA recognized a loss of $16.4 million in fiscal year 2010 which was primarily comprised of the net derivative balance for commodity contracts at the beginning of the year. Prior to this adoption, BPA recorded 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 13, Fair Value Measurements.)

At Sept. 30, 2012, the derivative commodity contracts recorded at fair value totaled 6.8 million MWh (gross basis) with delivery months extending to September 2017. BPA does not apply hedge accounting.

INTEREST RATE SWAP TRANSACTIONS

In fiscal year 2010, BPA terminated two floating-to-fixed LIBOR interest rate swaps which had been used to help manage interest rate risk related to its long-term variable Energy Northwest debt portfolio. BPA terminated both swaps in conjunction with its debt management action to refinance the related variable rate debt into fixed rate debt. This resulted in the realization of a $29.4 million loss, which was included in Nonfederal projects expenses, and the corresponding removal of the $31.2 million unrealized loss from Derivative instruments under Operating revenues.

DERIVATIVE ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

As of Sept. 30 — thousands of dollars	**2012**	2011
Assets		
Derivative instruments [1]		
Commodity contracts, gross	**$ 14,263**	$ 47,140
Less: netting [2]	**(2,122)**	(14,760)
Total, net	**$ 12,141**	$ 32,380
Liabilities		
Derivative instruments [1]		
Commodity contracts, gross	**$ (41,171)**	$ (42,182)
Less: netting [2]	**2,122**	14,760
Total, net	**$ (39,049)**	$ (27,422)

[1] Derivative instruments assets and liabilities are included in Deferred charges and other and Deferred credits and other in the Combined Balance Sheets, respectively. (See Note 5, Deferred Charges and Other and Note 11, Deferred Credits and Other.)
[2] Netting represents a balance sheet adjustment for same counterparty master netting arrangements.

Derivative instruments unrealized losses of $30.4 million and unrealized gains of $37.4 million were recorded in Regulatory assets and liabilities in the Combined Balance Sheets in fiscal years 2012 and 2011, respectively. Realized gain and losses are included in Sales and Purchased power in the Combined Statements of Revenues and Expenses as the contracts are delivered and settled.

13. Fair Value Measurements

BPA applies the 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. This accounting guidance defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and prescribes disclosures about fair value measurements. BPA applied fair value measurements to certain assets and liabilities including commodity and interest rate derivative instruments and nuclear decommissioning trusts and other investments in accordance with the accounting guidance.

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.

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 and certain agency securities as part of the special purpose corporations' trust funds investments.

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, 2012, and 2011.

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE ON A RECURRING BASIS

As of Sept. 30, 2012 — thousands of dollars

	Level 1	Level 2	Level 3	Netting[2]	Total
Assets					
Nonfederal nuclear decommissioning trusts					
Equity index funds	$100,050	$ —	$ —	$ —	**$ 100,050**
U.S. government obligation mutual funds	74,067	—	—	—	**74,067**
Corporate bond index funds	61,460	—	—	—	**61,460**
Cash and cash equivalents	21	—	—	—	**21**
Derivative instruments [1]					
Commodity contracts	—	258	14,005	(2,122)	**12,141**
Special purpose corporations' trust funds					
U.S. government sponsored enterprise obligations	—	73,117	—	—	**73,117**
U.S. government obligations	—	17,979	—	—	**17,979**
Total	$235,598	$ 91,354	$ 14,005	$ (2,122)	**$ 338,835**
Liabilities					
Derivative instruments [1]					
Commodity contracts	$ —	$(41,132)	$ (39)	$ 2,122	**$ (39,049)**
Total	$ —	$(41,132)	$ (39)	$ 2,122	**$ (39,049)**

As of Sept. 30, 2011 — thousands of dollars

	Level 1	Level 2	Level 3	Netting[2]	Total
Assets					
Nonfederal nuclear decommissioning trusts					
U.S. government obligation mutual funds	$ 86,834	$ —	$ —	$ —	$ 86,834
Equity index funds	74,923	—	—	—	74,923
Corporate bond index funds	37,028	—	—	—	37,028
Cash and cash equivalents	24	—	—	—	24
Derivative instruments [1]					
Commodity contracts	—	21,058	26,082	(14,760)	32,380
Special purpose corporations' trust funds					
U.S. government sponsored enterprise obligations	—	125,547	—	—	125,547
U.S. government obligations	—	1,052	—	—	1,052
Total	$198,809	$147,657	$ 26,082	$(14,760)	$ 357,788
Liabilities					
Derivative instruments [1]					
Commodity contracts	$ —	$(40,743)	$ (1,439)	$ 14,760	$ (27,422)
Total	$ —	$(40,743)	$ (1,439)	$ 14,760	$ (27,422)

[1] Derivative instruments assets and liabilities are included in Deferred charges and other and Deferred credits and other in the Combined Balance Sheets, respectively. (See Note 5, Deferred Charges and Other and Note 11, Deferred Credits and Other.) See Note 12, 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.

COMMODITY CONTRACTS

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 year ended Sept. 30 — thousands of dollars	**2012**	2011
Beginning Balance	**$ 24,643**	$ 17,655
Total unrealized gains (losses) included in:		
Regulatory assets and liabilities [1]	**(10,677)**	6,988
Ending Balance	**$ 13,966**	$ 24,643

[1] Unrealized gains and losses are included in Regulatory assets and liabilities in the Combined Balance Sheets. Realized gains and losses are included in Sales and Purchased power in the Combined Statements of Revenues and Expenses.

14. Commitments and Contingencies

INTEGRATED FISH AND WILDLIFE PROGRAM

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 projects that are consistent with the Northwest Power Act and that are consistent with the Pacific Northwest Power and Conservation Council's Columbia River Basin Fish and Wildlife Program. In addition, certain fish species are listed under the Endangered Species Act (ESA) as threatened or endangered. BPA is financially responsible for expenditures and other costs arising from conformance with the ESA and certain biological opinions (BiOp) prepared by the National Oceanic and Atmospheric Administration Fisheries Service and the U.S. Fish and Wildlife Service in furtherance of the ESA. BPA's total commitment including timing of payments under the Northwest Power Act, ESA and BiOp is not fixed or determinable. However, the current estimate of long-term fish and wildlife agreements with a contractual commitment which BPA has entered into is $911.9 million as of Sept. 30, 2012. These agreements will expire at various dates between fiscal years 2018 and 2025.

IRRIGATION ASSISTANCE

Scheduled distributions

As of Sept. 30 — thousands of dollars	
2013	$ 58,961
2014	52,549
2015	52,110
2016	60,957
2017	51,393
2018 and thereafter	389,974
Total	**$ 665,944**

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. In establishing power rates, particular statutory provisions guide the assumptions that BPA makes as to the amount and timing of such distributions. 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 are scheduled to total $665.9 million over a maximum of 66 years since the time the irrigation facilities were completed and placed in service. BPA is required by the Grand Coulee Dam - Third Powerplant Act to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA 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 repay these costs.

FIRM PURCHASE POWER COMMITMENTS

As of Sept. 30 — thousands of dollars		
2013	$	66,441
2014		35,234
2015		17,477
2016		19,026
2017		20,863
2018 and thereafter		44,877
Total	**$**	**203,918**

BPA periodically enters into long-term commitments to purchase power for future delivery. When BPA forecasts a resource shortage based on expected obligations and the historical water record for the Columbia River basin, BPA takes a variety of steps to cover the shortage including entering into power purchase commitments. Additionally, under BPA's current tiered rates structure, BPA's customers may request that BPA meet their power requirements in excess of their share of BPA's generation resources. BPA may meet these requests by entering into power purchase commitments. The above table includes firm purchase power agreements of known costs that are currently in place to assist in meeting expected future obligations under long-term power sales contracts. Included are six contracts for winter purchases through fiscal year 2014 and eight purchases made specifically to meet BPA's commitments to sell power at Tier 2 rates in fiscal years 2013 and 2015-2019. The expenses associated with the winter purchases for 2012, 2011 and 2010 were $43.4 million, $43.4 million and $43.1 million, respectively. The expense associated with Tier 2 purchases beginning in fiscal year 2012 was $8.5 million. BPA has several power purchase agreements with wind-powered and other generating facilities that are not included in the table above as payments are based on the variable amount of future energy generated and there are no minimum payments required.

ENERGY EFFICIENCY PROGRAM

BPA is required by the Pacific Northwest Electric Power Planning and Conservation Act to meet the net firm power load requirements of its customers in the Pacific Northwest. BPA is authorized to help meet its net firm power load through the acquisition of electric conservation measures. BPA offers a portfolio of initiatives and infrastructure support activities to its customers to ensure the conservation targets established in the Northwest Power and Conservation Council's Sixth Power Plan are achieved. These initiatives and activities are often executed via long-term conservation commitments made by BPA to its customers. These commitments are captured through $96.6 million of agreements with utility customers and contractors that provide support in the way of energy efficiency program research, development and implementation. The timing of the payments under these commitments is not fixed or determinable and these agreements will expire at various dates through fiscal year 2015.

1989 LETTER AGREEMENT

In 1989, BPA agreed with Energy Northwest that in the event any participant shall be unable, for any reason, or shall refuse to pay to Energy Northwest any amount due from such participant under its net billing agreement (for which a net billing credit or cash payment to such participant has been provided by BPA), BPA will be obligated to pay the unpaid amount in cash directly to Energy Northwest.

NUCLEAR INSURANCE

BPA is a member of the Nuclear Electric Insurance Limited (NEIL), a mutual insurance company established to provide insurance coverage for nuclear power plants. The insurance policies purchased from NEIL by BPA include: 1) Primary Property and Decontamination Liability Insurance; 2) Decontamination Liability, Decommissioning Liability and Excess Property Insurance; and 3) NEIL I Accidental Outage Insurance.

Under each insurance policy, BPA could be subject to a retrospective premium 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 Liability Insurance policy is $10.3 million. For the Decontamination Liability, Decommissioning Liability and Excess Property Insurance policy, the maximum assessment is $18.7 million. For the NEIL I Accidental Outage Insurance policy, the maximum assessment is $4.7 million.

As a separate requirement, BPA is liable under the Nuclear Regulatory Commission's indemnity for public liability coverage under the Price-Anderson Act. In the event of a nuclear accident resulting in public liability losses exceeding $375.0 million, BPA could be subject to a retrospective assessment of up to $111.9 million limited to an annual maximum of $17.5 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 material 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 as discussed below. BPA has recorded a liability of $28.5 million on the basis that all conditions have been met except the final resolution in the California refund proceedings and related litigation which management considers probable. However, interest payable has not been recorded because the amount that will be paid cannot be reasonably estimated. BPA established an offsetting regulatory asset, 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 FERC's refund authority over governmental utilities. In BPA v. FERC, 422 F.3d 908 (9th Cir. 2005) the Ninth Circuit Court found that governmental utilities, like BPA, were not subject to FERC's statutory refund authority. As a consequence of the Ninth Circuit 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 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.

A trial on the liability portion of plaintiffs' contractual breach claim commenced in July 2010 and concluded in August 2010. Post trial briefs were filed during fall 2010 and closing arguments were held in February 2011. In May 2012, the Court of Federal Claims issued an opinion in the trial on liability issues and held that BPA breached its contracts with the California parties by failing to pay refunds for amounts owed in excess of the mitigated market clearing prices during the refund period. Whether the amounts owed include interest is a contested issue. Assuming the amounts owed do include interest, such refund amounts could amount up to approximately $52 million if ultimately determined to be based on the differences between the mitigated market clearing prices and the prices actually transacted during this period. While this ruling does not establish a specific liability in this matter, BPA recorded a liability in this amount. A trial to determine the amount of damages is currently scheduled for June 2013.

The plaintiffs’ contractual breach was premised in part upon a November 2009 order where FERC found that as a consequence of establishing a new just and reasonable rate for the purpose of calculating refunds for jurisdictional utilities, it also retroactively reset the prices under the ISO and PX tariffs for all market participants. BPA separately appealed the November 2009 order to the Ninth Circuit Court. In August 2012, subsequent to the ruling of the Court of Federal Claims described above, the Ninth Circuit Court issued a decision on this appeal and held that establishing a new price for purposes of calculating refunds did not retroactively revise the rate for all market participants. The United States Department of Justice, representing BPA in this matter, expects to file a motion to reconsider the May 2012 decision of the Court of Federal Claims based upon this recent Ninth Circuit Court ruling.

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 and that were also incorporated in the WP-10 Rate Case. The petitioners in these cases challenge, among other issues, BPA’s calculation of certain refunds (referred to as "Lookback Amounts") associated with rates charged to BPA's preference customers from fiscal years 2002 through 2008. These refunds resulted from BPA's implementation of an REP settlement in fiscal years 2002 through 2008 that was later found unlawful and payment of REP benefits to BPA's investor-owned utility customers under that settlement. Following extensive negotiations, representatives from most of the region's consumer- and investor-owned utilities reached a proposed agreement on how BPA should establish REP benefits and recover the costs of those benefits through rates for the fiscal year period 2002 through 2028. BPA conducted a formal evidentiary hearing to review the proposed settlement agreement, which was signed by the administrator on July 2011. Since the 2012 REP Settlement Agreement (Settlement Agreement) completely replaces BPA’s REP-related WP-07 Supplemental Rate Case and WP-10 Rate Case decisions, BPA and many consumer-owned utilities have filed respective motions in the Ninth Circuit Court to dismiss pending litigation challenging those decisions. The cost of providing REP benefits will be recovered through future rates. BPA has recorded regulatory assets, a liability and a regulatory liability for the effects of the Settlement Agreement. (See Note 10, Residential Exchange Program.)

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; however, BPA 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 2012.

Judgments and settlements are included in BPA's costs and recovered through rates. Except with respect to the SCE, California parties' refund claims, and REP matters described above, BPA has not recorded a liability for the above legal matters. (See Note 11, Deferred Credits and Other, for discussion of amounts accrued for outstanding legal claims and settlements.)

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