

Management's Discussion & Analysis

General

The Bonneville Power Administration is proud to serve the 12 million people residing in the 300,000 square mile region known as the Pacific Northwest, which includes the states of Idaho, Oregon, Washington, western Montana, and small parts of western Wyoming, northern Nevada and northern California. BPA supplies nearly 35 percent of the electric power consumed in this region through wholesale power contracts with more than 100 publicly and cooperatively owned utilities. About 80 percent of this power comes from hydroelectric generation. The agency owns and operates three-fourths of the high-voltage transmission lines in the region.

Headquartered in Portland, Ore., BPA is a federal power marketing administration within the U.S. Department of Energy that is also a separate and distinct legal entity. Many of BPA's statutory authorities are vested in the Secretary of Energy, who appoints and acts by and through the BPA Administrator. Other statutory authorities are vested directly in the Administrator.

Congress created BPA in 1937 to market electricity from Bonneville Dam on the Columbia River and to construct transmission facilities to deliver that power. Today, BPA markets wholesale power from 31 federal hydroelectric projects, most of which are located in the Columbia River Basin. BPA also markets power from Energy Northwest's Columbia Generating Station nuclear power plant and the Cowlitz Falls hydro project.

BPA sells power and transmission services at cost and recovers through its power and transmission rates all costs of the Federal Columbia River Power System. BPA repays with interest the federal investment in the hydropower and transmission facilities of the FCRPS. Although BPA is not under the jurisdiction of the Federal Energy Regulatory Commission for most of its operations, it voluntarily provides open access, non-discriminatory transmission service to all requestors. In addition, BPA conforms to FERC standards of conduct to ensure its transmission function does not discriminatorily advantage its merchant power function.

BPA's largely hydroelectric power supply depends on the amount and shape of annual precipitation in the Columbia River Basin. BPA monitors snow pack that drains into the Columbia River basin to predict each year's water and secondary energy supply. BPA assumes the lowest historical runoff as the basis for calculating its available power supply to meet its firm power obligations. BPA sells secondary energy to purchasers in the Western Interconnection at market prices when available generation is in excess of what is needed to serve the region's obligations. When setting power rates, BPA assumes an average level of secondary energy sales. In an average water year BPA has about 1,400 to 1,600 average megawatts of secondary energy available for sale. Because precipitation and market prices vary widely,

BPA builds contingencies into its rates to cover poor hydro conditions. To ensure BPA is able to meet its financial responsibilities to counterparties and to the U.S. Treasury, BPA relies on risk mitigation measures such as financial reserves and cost recovery adjustment clauses in rates.

In May 2007, the United States Court of Appeals for the Ninth Circuit ruled invalid Residential Exchange Program settlements BPA had been operating under since 2001. The ruling effectively requires the agency to revisit its Residential Exchange Program. Due to the uncertainty created by the rulings, BPA suspended payments that normally reduce rates for residential and small-farm customers served by Northwest investor-owned utilities. BPA's IOU customers filed petitions for rehearing and rehearing en banc on July 18, 2007. The Ninth Circuit later denied the petitions for rehearing. On February 1, 2008, three investor-owned utility respondent-intervenors filed a petition for certiorari with the United States Supreme Court. Parties await the Court's ruling on the petition.

BPA is addressing the implications of the Ninth Circuit ruling in administrative proceedings. Any change to settlement benefits will be reflected in BPA's rate development and recovered through revised rates. In the meantime, BPA offered \$336 million for interim rate relief associated with the Residential Exchange Program. The majority of BPA's preference and investor-owned utility customers signed agreements by the March 24th deadline. Early in April 2008, BPA made payments to those utilities totaling \$281 million. The interim payments are subject to true-up once the agency determines the correct level of payments for FY 2008 in the 2007 Supplemental Wholesale Power Rate Case currently underway.

The FCRPS financial statements that follow are a combination of the accounts of the Bonneville Power Administration, the accounts of the Pacific Northwest generating facilities of both the U.S. Army Corps of Engineers and the Bureau of Reclamation as well as the operation and maintenance costs of the U.S. Fish and Wildlife Service for the Lower Snake River Compensation Plan Facilities. Consolidated with BPA are "Special Purpose Corporations" known as Northwest Infrastructure Financing Corporations, from which BPA leases certain transmission facilities.

Results of Operations

Operating Revenues

For the six months in the fiscal year-to-date ended March 31, 2008, revenues from combined Power Services and Transmission Services sales were down \$58 million, or 4 percent from the comparable period a year earlier, as reported under Segment Reporting. Power Services sales declined \$67 million or 5 percent. The decline is the result of lower stream flows reducing federal generation available for secondary sales. This decline was partially offset by higher market prices. Transmission Services sales increased \$9 million, or 3 percent. The change is mainly due to increased network and intertie transmission sales and associated ancillary services. Significant reasons for the increased revenues are

the result of increased Point-to-Point long-term and short-term sales and a slight increase in rates from last fiscal year.

The decline in the unrealized fair value of BPA's derivative mark-to-market portfolio of \$77 million was due primarily to the impact of increasing forward price curves on BPA's sales contracts.

U.S. Treasury credits for fish increased \$11 million, or 28 percent as stream flows declined and market prices for purchased power increased.

Operating Expenses

Operations and maintenance decreased \$54 million, or 7 percent for the six months ended March 31, 2008, from the comparable period a year earlier, as reported below in the Combined Statements of Revenues and Expenses. The higher amount last year was due to settlement of litigation over BPA's Slice of the System power product and the bi-annual refueling of Energy Northwest's Columbia Generating Station nuclear power plant.

Purchased power increased \$52 million, or 29 percent, due to a combination of higher prices and increased purchases as a consequence of lower stream flows and associated federal generation.

Nonfederal projects debt service increased \$71 million or 40 percent due to increased amortization for Energy Northwest Nuclear Project No. 1 and Project No. 3 bonds. The lower amortization for the prior period was the result of extension of nonfederal debt and early repayment of federal debt within the total FCRPS debt portfolio. The overall objective of these debt management actions has been to achieve an optimal total debt portfolio. The portfolio includes federal appropriations, bonds issued to the U. S. Treasury, and nonfederal projects debt.

Net Interest Expense

Interest on bonds issued to the U.S. Treasury declined \$3 million, or 5 percent for the six months ended March 31, 2008, from the comparable period a year earlier. The primary driver was a reduction of debt outstanding between periods. Allowance for funds used during construction increased \$5 million, or 77 percent with corresponding increases of construction work in progress for federal hydro generation plant and Columbia River fish mitigation. Interest income increased \$7 million, or 23 percent due to higher cash balances.

Liquidity and Capital Resources

Net Revenues and Operating Activities

As a result of the factors previously discussed, the FCRPS earned net revenues of \$123 million for the six months ended March 31, 2008. By comparison, net revenues were \$293 million for the six months ended March 31, 2007.

Cash provided by operating activities of the FCRPS decreased \$96 million to \$425 million for the six months ended March 31, 2008, compared to \$521 million for the comparable period a year earlier, as reported below in the Combined Statements of Cash Flows. The change in operating cash flow primarily reflects the changes in net revenues, net of the impact of changing derivative values, and differences in the timing of collecting receivables and payments of accounts payable and accrued liabilities.

Investment Activities

Cash used for investment activities of the FCRPS increased \$86 million to \$212 million for the six months ended March 31, 2008. A significant change between the periods was a transfer to BPA from the federal Spectrum Relocation Fund. During the second quarter of fiscal year 2007, BPA received approximately \$49 million to offset costs associated with relocating radio communications from displaced spectrum bands resulting from the National Telecommunications and Information Administration Organization Act. As such, the receipts were reflected as a source of investing cash. Another significant change between the periods was the deposit to Special Purpose Corporation's trust funds of \$38 million of proceeds from the Master Lease Program.

Financing Activities

Cash provided by financing activities of the FCRPS was \$40 million for the six months ended March 31, 2008, compared to \$39 million for the comparable period a year earlier. A net decrease in bonds issued to the U.S. Treasury of \$45 million was offset as Nonfederal debt increased \$38 million with a Northwest Infrastructure Financing Corporation II draw from Citibank under the Master Lease Program and an increase in Customer's advances for construction of \$10 million.

Non-GAAP Financial Information

Modified Net Revenues

Management has determined that modified net revenues are a better representation of the outcomes of normal operations during periods of debt management actions and fluctuations in derivative market

prices. Modified net revenues are net revenues after removing the effects of SFAS 133 derivative mark-to-market and nonfederal debt management actions that differ from rate case assumptions.

Modified net revenues were \$46 million lower for the six months ended March 31, 2008, compared to the comparable period a year earlier, primarily due to the decline in net revenues previously discussed. The table below demonstrates the calculation for modified net revenues.

Modified Net Revenues

*Federal Columbia River Power System
For the fiscal year-to-date ended March 31 — thousands of dollars*

	2008	2007
Net Revenues	\$ 122,570	\$ 293,015
SFAS 133 derivative mark-to-market	64,432	(12,283)
Nonfederal debt management actions	(70,062)	(118,229)
Modified net revenues	\$ 116,940	\$ 162,503

Additional Information

To see BPA's most recent annual report including audited financial statements, go to www.bpa.gov/corporate/finance/a_report

To see BPA's news, go to www.bpa.gov/corporate/BPAnews

For general information about BPA, refer to BPA's Home page at www.bpa.gov

For information on Power Services including rates, go to www.bpa.gov/power

For information about hydro power or current hydrological information, go to www.bpa.gov/power/pgf/hydrology/weekly.shtml

For information on Transmission Services including rates, go to www.transmission.bpa.gov

Federal Columbia River Power System Combined Balance Sheets

(Unaudited)

March 31,
2008

September 30,
2007

(thousands of dollars)

Assets		
Federal utility plant		
Completed plant	\$ 13,255,098	\$ 13,278,856
Accumulated depreciation	(4,877,222)	(4,825,295)
	8,377,876	8,453,561
Construction work in progress	969,382	851,620
Net federal utility plant	9,347,258	9,305,181
Nonfederal generation	2,460,300	2,465,230
Current assets		
Cash	1,728,281	1,475,544
Accounts receivable, net of allowance	111,633	140,335
Accrued unbilled revenues	222,663	181,526
Materials and supplies, at average cost	75,754	68,334
Prepaid expenses	25,379	19,938
Total current assets	2,163,710	1,885,677
Other assets		
Regulatory assets	5,727,297	5,938,724
Nonfederal nuclear decommissioning trusts	161,838	162,438
Deferred charges and other	206,311	206,398
Total other assets	6,095,446	6,307,560
Total assets	\$ 20,066,714	\$ 19,963,648
Capitalization and Liabilities		
Capitalization and long-term liabilities		
Accumulated net revenues	\$ 2,525,135	\$ 2,402,565
Federal appropriations	4,367,631	4,326,688
Bonds issued to U.S. Treasury	1,735,900	1,760,900
Nonfederal debt	6,290,300	6,262,295
Total capitalization and long-term liabilities	14,918,966	14,752,448
Commitments and contingencies (See Note 9 to annual financial statements)		
Current liabilities		
Federal appropriations	10,913	10,913
Bonds issued to U.S. Treasury	464,600	479,600
Nonfederal debt	289,158	288,758
Accounts payable and other	640,544	346,352
Total current liabilities	1,405,215	1,125,623
Other Liabilities		
Regulatory liabilities	2,018,671	2,050,228
IOU exchange benefits	741,046	1,068,217
Asset retirement obligations	178,600	175,500
Deferred credits	804,216	791,632
Total other liabilities	3,742,533	4,085,577
Total capitalization and liabilities	\$ 20,066,714	\$ 19,963,648

Federal Columbia River Power System Combined Statements of Revenues and Expenses

(Unaudited)

	Three Months Ended March 31,		Fiscal Year-to-Date Ended March 31,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(thousands of dollars)			
Operating revenues	\$ 799,623	\$ 880,672	\$ 1,580,943	\$ 1,699,600
Operating expenses				
Operations and maintenance	345,323	373,460	692,889	746,897
Purchased power	97,581	67,444	231,422	179,203
Nonfederal projects	125,145	87,509	246,418	175,465
Depreciation and amortization	89,034	89,131	177,565	178,806
Total operating expenses	657,083	617,544	1,348,294	1,280,371
Net operating revenues	142,540	263,128	232,649	419,229
Interest (income) and expense				
Interest on federal investment:				
Appropriated funds	49,119	48,622	98,198	99,007
Bonds issued to U.S. Treasury	30,755	32,262	61,528	64,724
Allowance for funds used during construction	(5,860)	(2,315)	(11,567)	(6,550)
Interest income	(19,551)	(15,768)	(38,080)	(30,967)
Net interest expense	54,463	62,801	110,079	126,214
Net revenues	\$ 88,077	\$ 200,327	\$ 122,570	\$ 293,015

Federal Columbia River Power System
Combined Statements of Cash Flows
(Unaudited)

Fiscal Year-to-Date Ended
March 31,

2008

2007

(thousands of dollars)

Cash provided by operating activities

Net revenues	\$	122,570	\$	293,015
Non-cash items:				
Depreciation and amortization		177,565		178,806
Amortization of capitalization adjustment		(32,452)		(32,452)
Changes in:				
Receivables and unbilled revenues		(12,435)		27,659
Materials and supplies		(7,420)		(4,388)
Prepaid expenses		(5,441)		(3,484)
Accounts payable and other		242,451		41,986
Other assets and liabilities		(59,874)		19,679
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Cash provided by operating activities		424,964		520,821

Cash provided by and (used for) investment activities

Investment in:				
Federal utility plant (including AFUDC)		(184,039)		(179,773)
Nonfederal generation		4,930		4,700
Transfer from Spectrum Relocation Fund		-		48,627
Nonfederal nuclear decommissioning trusts		(3,559)		-
Special purpose corporation's trust funds:				
Deposits to		(37,720)		-
Receipts from		8,429		-
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Cash used for investment activities		(211,959)		(126,446)

Cash provided by and (used for) financing activities

Increase (repayment):				
Federal construction appropriations				
Increase		40,943		42,566
Repayment		-		-
Bonds issued to U.S. Treasury				
Increase		95,000		130,000
Repayment		(115,000)		(125,000)
Refinanced		(20,000)		-
Nonfederal debt				
Increase		37,720		-
Repayment		(9,315)		(8,895)
Customer's advances for construction		10,384		-
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Cash provided by (used for) financing activities		39,732		38,671
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Increase in cash		252,737		433,046
Beginning cash balance		1,475,544		1,225,075
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Ending cash balance	\$	1,728,281	\$	1,658,121

Federal Columbia River Power System

Segment Reporting

(Unaudited)

Three Months Ended

March 31,

2008

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 661,050	\$ 171,868	\$ -	\$ 832,918
Bookouts	(24,955)	-	-	(24,955)
Derivative mark-to-market	(48,313)	-	-	(48,313)
Miscellaneous revenues	7,030	7,776	-	14,806
U.S. Treasury credits for fish	25,167	-	-	25,167
Total unaffiliated revenues	619,979	179,644	-	799,623
Intersegment revenues	15,478	26,794	(42,272)	-
Total operating revenues	635,457	206,438	(42,272)	799,623
Operating expenses				
Unaffiliated expenses	506,421	73,934	(12,306)	568,049
Depreciation	44,998	44,036	-	89,034
Intersegment expenses	26,794	15,477	(42,271)	-
Total operating expenses	578,213	133,447	(54,577)	657,083
Net operating revenues	57,244	72,991	12,305	142,540
Interest expense				
Interest expense	50,667	36,600	(13,253)	74,014
Interest income	(14,932)	(4,619)	-	(19,551)
Net interest expense	35,735	31,981	(13,253)	54,463
Net (expenses) revenues	\$ 21,509	\$ 41,010	\$ 25,558	\$ 88,077

2007

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
	(thousands of dollars)			
Unaffiliated revenues				
Sales	\$ 686,741	\$ 165,507	\$ -	\$ 852,248
Bookouts	(18,646)	-	-	(18,646)
Derivative mark-to-market	12,521	-	-	12,521
Miscellaneous revenues	8,523	7,004	-	15,527
U.S. Treasury credits for fish	19,022	-	-	19,022
Total unaffiliated revenues	708,161	172,511	-	880,672
Intersegment revenues	20,448	27,347	(47,795)	-
Total operating revenues	728,609	199,858	(47,795)	880,672
Operating expenses				
Unaffiliated expenses	499,357	68,032	(38,976)	528,413
Depreciation	43,922	45,209	-	89,131
Intersegment expenses	27,347	20,448	(47,795)	-
Total operating expenses	570,626	133,689	(86,771)	617,544
Net operating revenues	157,983	66,169	38,976	263,128
Interest expense				
Interest expense	51,214	38,111	(10,756)	78,569
Interest income	(11,733)	(4,035)	-	(15,768)
Net interest expense	39,481	34,076	(10,756)	62,801
Net revenues	\$ 118,502	\$ 32,093	\$ 49,732	\$ 200,327

Derivative instruments and hedging activities

The derivative mark-to-market amount is an "accounting only" (no cash impact) adjustment representing the adjustment required by SFAS 133, as amended, for identified derivative instruments.

Federal Columbia River Power System

Segment Reporting

(Unaudited)

Fiscal Year-to-Date Ended
March 31,
2008

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
(thousands of dollars)				
Unaffiliated revenues				
Sales	\$ 1,268,549	\$ 333,174	\$ -	\$ 1,601,723
Bookouts	(36,715)	-	-	(36,715)
Derivative mark-to-market	(64,432)	-	-	(64,432)
Miscellaneous revenues	15,131	17,114	-	32,245
U.S. Treasury credits for fish	48,122	-	-	48,122
Total unaffiliated revenues	1,230,655	350,288	-	1,580,943
Intersegment revenues	30,698	53,536	(84,234)	-
Total operating revenues	1,261,353	403,824	(84,234)	1,580,943
Operating expenses				
Unaffiliated expenses	1,051,438	143,804	(24,513)	1,170,729
Depreciation	89,640	87,925	-	177,565
Intersegment expenses	53,536	30,698	(84,234)	-
Total operating expenses	1,194,614	262,427	(108,747)	1,348,294
Net operating revenues	66,739	141,397	24,513	232,649
Interest expense				
Interest expense	101,408	73,239	(26,488)	148,159
Interest income	(29,294)	(8,786)	-	(38,080)
Net interest expense	72,114	64,453	(26,488)	110,079
Net (expenses) revenues	\$ (5,375)	\$ 76,944	\$ 51,001	\$ 122,570

2007

	<u>Power</u>	<u>Transmission</u>	<u>Other</u>	<u>FCRPS</u>
(thousands of dollars)				
Unaffiliated revenues				
Sales	\$ 1,336,019	\$ 323,980	\$ -	\$ 1,659,999
Bookouts	(42,397)	-	-	(42,397)
Derivative mark-to-market	12,283	-	-	12,283
Miscellaneous revenues	17,385	14,782	-	32,167
U.S. Treasury credits for fish	37,548	-	-	37,548
Total unaffiliated revenues	1,360,838	338,762	-	1,699,600
Intersegment revenues	38,886	55,421	(94,307)	-
Total operating revenues	1,399,724	394,183	(94,307)	1,699,600
Operating expenses				
Unaffiliated expenses	1,045,835	133,640	(77,910)	1,101,565
Depreciation	89,292	89,514	-	178,806
Intersegment expenses	55,324	38,885	(94,209)	-
Total operating expenses	1,190,451	262,039	(172,119)	1,280,371
Net operating revenues	209,273	132,144	77,812	419,229
Interest expense				
Interest expense	102,904	75,808	(21,531)	157,181
Interest income	(23,244)	(7,723)	-	(30,967)
Net interest expense	79,660	68,085	(21,531)	126,214
Net revenues	\$ 129,613	\$ 64,059	\$ 99,343	\$ 293,015

Operating Segments

In fiscal year 1997 BPA opted to implement FERC's open-access rulemaking and standards of conduct. FERC requires that transmission activities are functionally separate from wholesale power merchant functions and that transmission is provided in a nondiscriminatory open-access manner.

The FCRPS' major operating segments are defined by the utility functions of generation and transmission. Power Services represents the operations of the generation function, while Transmission Services represents the operations of the transmission function. Power and Transmission Services are not separate legal entities. Each FCRPS segment operates predominantly in one industry and geographic region: the generation and transmission for electric power in the Pacific Northwest.

Where applicable, "Other" represents items that are necessary to reconcile to the financial statements. These generally include Corporate shared activities which is primarily income due to debt reassignment and eliminations.

The FCRPS centrally manages all interest expense activity. Since BPA has one fund with the U.S. Treasury, all cash and cash transactions are also centrally managed. Unaffiliated revenues represent sales to external customers for each segment. Intersegment revenues are eliminated.

Major Customers

During the reported periods no single customer represented 10% or more of the FCRPS' revenues.